Petition

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No.

In the Supreme Court of the United States

OCTOBER TERM, 1981

CHARLES A. BOWSHER, COMPTROLLER GENERAL OF THE UNITED STATES, AND UNITED STATES OF AMERICA, PETITIONERS

v.

MERCK & CO., INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTION PRESENTED

Whether, with respect to negotiated government contracts, the Comptroller General is authorized by law to examine the contractor's books and records pertaining to costs of research and development, advertising and promotion, distribution, and administration, where such costs, although not allocated by the contractor to particular products or calculated on a product basis in determining price, are defrayed by the contractor from commingled general revenues that include the government's payments under the contract.

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v.

MERCK & CO., INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Solicitor General, on behalf of the Comptroller General of the United States and the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, 1a–32a) is not yet reported. The opinion of the district court (App. C, *infra*, 35a–40a) is not reported.

JURISDICTION

The judgment of the court of appeals (App. B, *infra*, 33a–34a) was entered on September 10, 1981. On December 4, 1981, the Chief Justice extended the time for filing a petition for a writ of certiorari to and including January 8, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

1. 10 U.S.C. 2313(b) provides:

> Except as provided in subsection (c), each contract negotiated under this chapter shall provide that the Comptroller General and his representatives are entitled, until the expiration of three years after final payment, to examine any books, documents, papers, or records of the contractor, or any of his subcontractors, that directly pertain to, and involve transactions relating to, the contract or subcontract.

2. 41 U.S.C. 254(c) provides:

> All contracts negotiated without advertising pursuant to authority contained in this Act shall include a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall until the expiration of three years after final payment have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors engaged in the performance of and involving transactions related to such contracts or subcontracts. Under regulations to be prescribed by the Administrator, however, such clause may be omitted from contracts with foreign contractors or foreign subcontractors if the agency head determines, with the concurrence of the Comptroller General of the United States or his designee, that the omission will serve the best interests of the United States. However, the concurrence of the Comptroller General of the United States or his designee is not required for the omission of such clause—
>
> (1) where the contractor or subcontractor is a foreign government or agency thereof or is precluded by the laws of the country involved from making its books, documents, papers, or records available for examination; and
>
> (2) where the agency head determines, after taking into account the price and availability of the property or services from United States sources, that the public interest would be best served by the omission of the clause.

If the clause is omitted based on a determination under clause (2) a written report shall be furnished to the Congress. The power of the agency head to make the determination specified in the preceding sentences shall not be delegable.

STATEMENT

1. In 1973 respondent Merck & Co., Inc. (Merck) entered into three contracts with the Defense Supply Agency of the Department of Defense and one contract with the Veterans Administration for the sale of pharmaceutical products to the government. All four contracts were negotiated fixed-price contracts,[1] with a total price of more than $2.8 million (App. A, *infra*, 25a; C.A. App. 34–37).[2] As required by 10 U.S.C. 2313(b)[3] and 41 U.S.C. 254(c),[4] each of the contracts contained a standard access-to-records provision in which the contractor agreed that "the Comptroller General of the United States * * * shall * * * have access to and the right to examine any directly pertinent * * * records of the contractor * * * involving transactions related to [this contract]" (App. A, *infra*, 2a; C.A. App. 23–24).

Pursuant to these statutory and contractual provisions, the Comptroller General, by letter of August 26, 1974, made a timely request of Merck for access to designated records. The Comptroller General explained that the request was part of "a review of the procurement of drugs by agencies of the Federal Government, including the pricing of drugs and pharmaceuticals procured under negotiated contracts" (C.A. App. 49). To that end, the Comptroller General sought to examine (C.A. App. 50):

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[1] A negotiated government contract is a method of procurement authorized by statute to be used in situations in which the formal public advertising and bidding procedure is deemed impractical or unnecessary. See 10 U.S.C. 2304(a); 41 U.S.C. 252(c).

[2] "C.A. App." refers to the joint appendix filed by the parties in the court of appeals.

[3] See page 2, *supra*. This provision is applicable to the Defense Supply Agency contracts.

[4] See pages 2–3, *supra*. This provision is applicable to the Veterans Administration contract.

> all books, documents, papers, and other records directly pertinent to the contracts, which include, but are not limited to (1) records of experienced costs, including costs of direct materials, direct labor, overhead, and other pertinent corporate costs, (2) support for prices charged to the Government, and (3) such other information as may be necessary for use to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government's interests.

2. Respondent refused to comply with the Comptroller General's request. Instead, on October 2, 1974, it commenced the present action in the United States District Court for the District of Columbia seeking declaratory and injunctive relief to bar the General Accounting Office (GAO) from access to its records (C.A. App. 5–12). The United States subsequently intervened in the action and filed a counterclaim to require respondent to allow the requested inspection (C.A. App. 21–27).

Following discovery, the district court on August 12, 1977, granted in part and denied in part each party's motion for summary judgment (App. C, *infra*, 35a–40a). The court rejected respondent's arguments that the Comptroller General's request was based on the assertedly improper purpose of "conduct[ing] an economic survey of the pharmaceutical industry" rather than the concededly proper purpose of "ensur[ing] that the prices [the government] pays are reasonable and appropriate" (*id.* at 36a), and that no cost records were subject to disclosure because "the contract prices were not cost based" (*ibid.*). Instead, relying principally on *Hewlett-Packard Co.* v. *United States*, 385 F.2d 1013 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968), the court held that GAO examination of records for non-cost-based contracts "accommodates [the] governmental interest in supervising and controlling the procurement process in precisely the manner intended by Congress * * * [and] that the survey proposed by the Comptroller in this case * * * will facilitate supervision of the procurement process and is within his authority" (App. C, *infra*, 38a). Accordingly, the court declined to follow "the restrictive

approach to [the] access-to-records clauses taken" (*ibid.*) by the district court in *Eli Lilly & Co.* v. *Staats*, a decision that was later reversed by the Seventh Circuit. See 574 F.2d 904 (7th Cir.), cert. denied, 439 U.S. 959 (1978).

With respect to the scope of access, however, the district court held (App. C, *infra*, 38a–40a) that access should be limited to records of manufacturing and delivery costs in accordance with the district court's decision in *Bristol Laboratories* v. *Staats*, 428 F. Supp. 1388 (S.D.N.Y. 1977), aff'd, 620 F.2d 17 (2d Cir. 1980), aff'd by an equally divided court, 451 U.S. 400 (1981). On this ground, the court denied GAO access to records concerning respondent's unallocated costs of research and development, marketing and promotion, distribution, and administration (App. C, *infra*, 40a).

Pursuant to its opinion, the court ordered (App. C, *infra*, 39a–40a):[5]

> that the Comptroller General of the United States and his duly authorized representatives have the right to examine all books, documents, papers, or records directly pertaining to the pricing and cost of producing the items furnished by [respondent] under the following contracts * * *, including manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision), manufacturing overhead (including plant administration, production planning, warehousing, utilities and security), royalty expenses, and delivery costs; and it is
>
> FURTHER ORDERED, that defendant Comptroller General shall not demand access to books, documents, papers, or records with respect to research and development, marketing and promotion, distribution, and administration (except to the extent such data may be included in the cost items listed above) * * *.

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[5] On respondent's motion to alter or amend the judgment, the district court entered a revised judgment on January 24, 1979 (App. D, *infra*, 41a–44a). Among other things, the revised judgment added provisions to protect the confidentiality of records produced by respondent pursuant to GAO's request, but it did not alter the scope of access afforded GAO by the initial order (App. D, *infra*, 42a).

3. Both sides appealed to the United States Court of Appeals for the District of Columbia Circuit. During the pendency of the appeal, this Court granted the government's petition for a writ of certiorari in *Staats* v. *Bristol Laboratories*, *supra*. The court of appeals, accordingly, deferred decision in this case pending disposition of *Bristol Laboratories*.[6] On April 29, 1981, this Court affirmed the Second Circuit judgment in *Bristol Laboratories*, by an equally divided Court (Justice Stewart not participating) (451 U.S. 400).

Following this Court's action in *Bristol Laboratories*, a divided panel of the District of Columbia Circuit affirmed the district court's judgment in this case (App. A, *infra*, 1a–32a). The panel majority cited the conflicting decisions among the lower courts on the issues presented and disposed of the case as follows (App. A, *infra*, 3a):

> The scope and meaning of the statutory access-to-records provision have been thoroughly considered in the decisions we have cited. Conflicts in those decisions must be resolved by the Supreme Court, not by us, and we believe that nothing would be gained by a replowing of the field. Accordingly, without more, we affirm the judgment of the District Court filed January 24, 1979, pursuant to the District Court's memorandum opinion filed August 12, 1977.

Judge Mikva dissented. Not content with the majority's summary disposition, Judge Mikva expressed the view that "we must fulfill our obligation to provide guidance on this issue until the Supreme Court has spoken * * *" (App. A, *infra*, 4a). In a thorough and detailed opinion, he concluded that "Congress intended to give the Comptroller General exactly the sort of authority he seeks to exert here" (*ibid.*). Agreeing with the Seventh Circuit's holding in *Eli Lilly & Co.* v. *Staats*, *supra*, and citing relevant legislative history, Judge Mikva stated that "[t]he test of 'directly pertinent'"—the term that defines the scope of the Comp-

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[6] While the appeal in this case was pending in the court of appeals, Merck filed a conditional petition for a writ of certiorari before judgment. The petition was denied on December 8, 1980. 449 U.S. 1038.

troller General's access rights—is "whether [the] documents will assist the government to determine whether its negotiating practices sufficiently protect it from wasteful, fraudulent, or inefficient procurement practices" (App. A, *infra*, 30a). Under this test, Judge Mikva continued, "there is absolutely no legally compelling basis on which to conclude that such access extends to the manufacturing but not to the research and development costs of pharmaceutical companies such as Merck" (*id.* at 32a).

REASONS FOR GRANTING THE PETITION

1. This case raises the same important issue that the Court considered but left unresolved last Term in *Staats* v. *Bristol Laboratories*, 451 U.S. 400 (1981). The issue concerns the scope of the Comptroller General's right to request records from government contractors pursuant to contractual provisions required by statute to be included in all non-advertised government contracts in excess of $10,000.[7]

As the court of appeals recognized (App. A, *infra*, 3a), the circuit courts have reached conflicting decisions on this issue. Compare *Eli Lilly & Co.* v. *Staats*, 574 F.2d 904 (7th Cir.), cert. denied, 439 U.S. 959 (1978), and *United States* v. *Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979), with *Bristol Laboratories* v. *Staats*, 620 F.2d 17 (2d Cir. 1980[8]. All of these cases arose out of identical demands by

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[7] Although 10 U.S.C. 2313(b) and 41 U.S.C. 254(c) nominally apply to negotiated contracts of any dollar amount, the government's standard form contract requires the insertion of the records access clause only in negotiated supply contracts that exceed or may exceed $10,000. See 41 C.F.R. 1-16.901-32 (1978); App. A, *infra*, 6a n. 4.

[8] Subsequent to the court of appeals' decision in this case, the Third Circuit decided *SmithKline Corp.* v. *Staats*, No. 80-1464 (Dec. 28, 1981), vacating 483 F. Supp. 712 (E.D. Pa), conditional petition for cert. before judgment denied, 449 U.S. 1037 (1980), a case also arising out of an identical demand under an identical access-to-records provision. The Third Circuit concluded that the Comptroller General was authorized to seek the documents, but limited access to records of "manufacturing costs, manufacturing overhead, royalty expenses, and delivery costs" (slip op. 27). The contractor was not required to pro-

the Comptroller General, under identical records access provisions, for cost data pertaining to pharmaceutical products supplied to the government pursuant to negotiated fixed-price contracts.

Resolution of the conflict by this Court is as warranted today as it was when the Court granted the petition for a writ of certiorari in *Bristol Laboratories*. The Second, Third, and District of Columbia Circuits have disagreed with the Seventh Circuit on the proper construction of identical access-to-records provisions, thus hampering the Comptroller General's ability to fulfill his duties on a uniform, nationwide basis. Although the construction of this contractual provision should not depend on the location of the contractor or the venue of a lawsuit, that is precisely the present situation. Forum shopping is thus encouraged, since contractors have an incentive to file suit in the Second, Third or District of Columbia Circuits whenever possible. Moreover, the existing conflict could lead to a lack of cooperation by contractors in numerous industries and, consequently, to further litigation in other circuits.

2. The decision below has misconstrued the access-to-records provisions and unduly restricts the Comptroller General's authority to promote sound government procurement practices. When the records access provisions were enacted, Congress expressed its determination that "negotiated contracts * * * require close supervision and control * * * *" H.R. Rep. No. 791, 82d Cong., 1st Sess. 2 (1951); S. Rep. No. 603, 82d Cong., 1st Sess. 2 (1951).

The Seventh and Ninth Circuits have broadly construed the access-to-records provisions to effectuate the stated congressional intent. As the court of appeals explained in *Hewlett-Packard Co.* v. *United States*, *supra*, 385 F.2d at 1016, the Comptroller General is empowered to investigate whether a contractor's costs are "out of line with the contract price" and hence whether "the contract may have been an inappropriate means of meeting this particular pro-

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duce records concerning "research and development, marketing and promotion, distribution and administration, except to the extent that these costs may be included in the manufacturing costs" (*ibid.*).

curement need of the Government." Similarly, in *Eli Lilly & Co.* v. *Staats*, *supra*, the court of appeals followed "the broad reading of *Hewlett-Packard* * * * [as] most consistent with the plain meaning of the statutory language and with the legislative history" (574 F.2d at 913), and concluded that Congress envisioned "an inquiry [by the Comptroller General] into whether costs are excessive" (*id.* at 915). In departing from this understanding, the decision below frustrates the statutory objective.

3. GAO has consistently construed the records access provisions to authorize examination of all cost records necessary to determine the reasonableness of the prices charged the government. Congress, although aware of this construction, has not indicated its disapproval of the agency's interpretation or amended the statutes to reject that position. See *Hearings on Relation of Cost Data to Military Procurement Before the Subcomm. for Special Investigations of the House Comm. on Armed Services*, 88th Cong., 1st Sess. 3, 10–11, 23 (1963); *Hearings on Comptroller General Reports to Congress on Audits of Defense Contracts Before the Subcomm. on Military Operations of the House Comm. on Government Operations*, 89th Cong., 1st Sess. 44–45, 147, 513 (1965); *Hearings on Competitive Problems in the Drug Industry Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business*, 92d Cong., 1st Sess. 8018–8019 (1971).

In light of this history, the court of appeals was plainly unwarranted in rejecting GAO's longstanding interpretation of the access-to-records provisions. See *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 915. If allowed to stand, the decision below will limit the Comptroller General's inquiry into the appropriateness of contract prices to allocated costs of production and delivery and will hamper scrutiny of significant unallocated costs such as research and development, marketing and promotion, distribution, and administration.[9] This is a limitation Congress clearly never intended.

[9] Direct manufacturing and distribution costs of individual pharmaceutical products have been estimated to constitute as little as 9% of the sales price of such products (App. A, *infra*, 24a–25a).

The conflict should be resolved at this time, so that legitimate efforts by the Comptroller General to make government-wide determinations and recommendations concerning reduction or elimination of waste and inefficiency in government contracts can proceed, as Congress intended, based on evaluation of all relevant and necessary empirical data.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JANUARY 1982

Appendix

APPENDIX A

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 79-1435

MERCK & CO., INC., APPELLANT

v.

ELMER B. STAATS, COMPTROLLER, ET AL.

No. 79-1438

MERCK & CO., INC.

v.

ELMER B. STAATS, COMPTROLLER, ET AL., APPELLANTS

Appeals from the United States District Court for the District of Columbia

(D.C. Civil No. 74-1447)

Argued February 11, 1980

Decided September 10, 1981

Judgment entered this date

Before: TAMM, ROBB and MIKVA, *Circuit Judges*

Opinion *Per Curiam.*

Opinion concurring in part and dissenting in part filed by *Circuit Judge* MIKVA.

PER CURIAM: The issue in this case is the scope of the authority of the Comptroller General to examine records of Merck & Company relating to four contracts, negotiated without advertising, for sale of pharmaceutical products to the Department of Defense and the Veterans Administration. The right of the Comptroller to examine records is based on 10 U.S.C. § 2313(b) (1976) and 41 U.S.C. § 254(c) (1976), the latter of which requires that the following language appear in government contracts negotiated without advertising:

> [T]he Comptroller General . . . shall . . . have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor . . . involving transactions related to [this contract]. . . .

Each of the Merck contracts contained such a provision. Relying upon it the Comptroller General requested access to Merck's records directly pertinent to the pricing and cost of items furnished under each Merck contract. Merck denied the request and this litigation followed.

The District Court granted the Comptroller General access to "all books, documents, papers, or records directly pertaining to the pricing and cost of producing the items furnished by plaintiff Merck . . ." under the contracts. However, the District Court enjoined the Comptroller from demanding access to "books, docu-

ments, papers, or records with respect to research and development, marketing and promotion, distribution, and administration . . ." except as included in the prior grant. Both Merck and the government appeal.

On September 16, 1980 Merck filed a conditional petition for a writ of certiorari before judgment. The petition was denied December 8, 1980, —— U.S. ——, 101 S. Ct. 618 (1980).

This is one of several related cases in various circuits, challenging demands by the Comptroller General to examine the records of pharmaceutical companies pursuant to the access-to-records statutes, 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c). *See Staats v. Bristol Laboratories Division of Bristol-Myers Co.*, 428 F. Supp. 1388 (S.D.N.Y. 1977), 620 F.2d 17 (2d Cir. 1980), *aff'd by evenly divided court*, —— U.S. ——, 49 U.S.L.W. 4471 (1981); *SmithKline Corp. v. Staats*, 483 F. Supp. 712, (E.D. Pa. 1980), *appeal pending* No. 80-1464 (3d Cir. Mar. 19, 1980), *conditional petition for certiorari before judgment denied* December 8, 1980, —— U.S. ——, 101 S. Ct. 619 (1980); *Eli Lilly & Co. v. Staats*, 574 F.2d 904 (7th Cir. 1978), *cert. denied*, 439 U.S. 959 (1978); *United States v. Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979); *Cf. Hewlett-Packard Co. v. United States*, 385 F.2d 1013 (9th Cir. 1967), *cert. denied*, 390 U.S. 988 (1968).

The scope and meaning of the statutory access-to-records provision have been thoroughly considered in the decisions we have cited. Conflicts in those decisions must be resolved by the Supreme Court, not by us, and we believe that nothing would be gained by a replowing of the field. Accordingly, without more, we affirm the judgment of the District Court filed January 24, 1979, pursuant to the District Court's memorandum opinion filed August 12, 1977.

So ordered.

MIKVA, *Circuit Judge, concurring in part and dissenting in part*: The core issue of this case is the right of the government to have access to information pertaining to government contractors. Because it is the government, and because of its size, the role of the federal government as the purchaser of goods and services is hard to square with the free market concept of a willing purchaser doing business with a willing seller. Aware of these difficulties, Congress sought to make the government's role easier by creating the right of access to records of government contractors.[1] I recognize that the access-to-records provision has received thorough consideration in the cases cited by the majority, and that conflicts in those decisions must be resolved by the Supreme Court. But I also believe that we must fulfill our obligation to provide guidance on this issue until the Supreme Court has spoken, should it decide to do so.[2] I too shall try to avoid "replowing the field," but I cannot agree that the district court paid sufficient heed to the congressional purpose in requiring these access provisions in government contracts negotiated without advertising. The legislative history establishes that Congress intended to give the Comptroller General exactly the sort of authority he seeks to exert here. To the extent the district court found to the contrary, it should be reversed.

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[1] The clause, granting the Comptroller General access to "directly pertinent" cost data of contractors whose contracts are negotiated without advertising, is based on the Act of October 31, 1951, 65 Stat. 700, codified at 10 U.S.C. § 2313(b) (1976) and 41 U.S.C. § 254(c) (1976).

[2] The Supreme Court has denied certiorari or conditional petitions for certiorari before judgment in four cases arising under the access clause, including this one. —— U.S. ——, 101 S.Ct. 618 (1981). When the Court did hear *Staats v. Bristol Laboratories Division of Bristol-Myers Co.*, —— U.S. ——, 101 S. Ct. 2037 (1981), the decision was affirmed without comment by an equally divided Court. Hence there has been no dispositive word from the Court.

This litigation [3] poses two questions of statutory interpretation. First, for what purposes may the government exercise its rights under the access-to-records clause? Second, what is the scope of the access provision when it is properly invoked? The district court's opinion, which we now affirm almost casually, holds that the government properly invoked the access clause with regard to the four contracts it entered with Merck & Co., Inc. (Merck) in 1974. Memorandum and Order, Aug. 12, 1977, Joint Appendix (J.A.) at 511. That opinion limited governmental access considerably, however, and held that Merck's data concerning such costs as research, development, marketing, promotion, distribution, and general administration do not come within the scope of the access provision. *Id.*, J.A. at 513. I agree with the first holding, which is supported by precedent and legislative history. I disagree with the second holding, however, which disendows the usefulness of the information that the court allows the government to gain. Such an incongruous result does not comport with the manifest congressional purpose in enacting the access-to-records statutes.

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[3] Identical demands by GAO for the cost records of other drug companies have led to extensive litigation in other circuits. See majority opinion at 3. These demands grew out of a two-phase study of the economics of the pharmaceutical industry initiated by GAO in 1972. Phase I of the study, in which a number of companies participated voluntarily, was designed to give GAO "an understanding of the drug manufacturing industry," and Phase II was to be a more detailed study that would develop data for a comprehensive presentation to Congress. Voluntary participation by the companies had broken down by August, 1974, leading the Comptroller General to make a formal demand for access to Merck's cost data under the contract clause. Merck filed an action for declaratory relief in October, 1974, and the United States counterclaimed seeking access. After cross-motions for summary judgment, the district court issued an order on August 12, 1977, and modified that order in January, 1979. Both parties appeal from that order.

I. Proper Applications of the Access Clause

At issue here are four fixed-price contracts for the sale of drugs negotiated in 1973 between Merck and the United States Government. Each of the contracts incorporated by reference a standard form access clause:

> The Contractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment under this contract, have access to and the right to examine any directly pertinent books, documents, papers and records of the Contractor involving transactions related to this contract.

J.A. 24. Under the access-to-records provision, such a clause is required by law to be added to all government contracts for more than $10,000 which are negotiated without advertising.[4] It is important to realize at the outset, then, that we interpret a clause in contracts entered freely by Merck, and not the validity of some administrative agency's demand for involuntary access to private business records.

The legislative history of the access-to-records statutes provides compelling evidence that Congress expected the General Accounting Office (GAO) to use the statutes to improve government procurement methods, and not merely to combat and deter fraud. Every circuit to examine this question has come to this conclusion, as did the lower court here, and Merck's argument to the contrary reopens a question that ought to be considered closed. Nevertheless, because the basic premise of the statutes

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[4] By their terms, 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c) apply to negotiated contracts of any dollar amount. The government's standard form contract, however, requires insertion of the access clause only in negotiated supply contracts which exceed or may exceed $10,000. 41 C.F.R. § 1-16.901-32 (1978).

sheds light on my disagreement with the court below, it may be useful to review Merck's contentions and explain why they lack merit.

Merck opposes governmental access to its records under the statutes on three main grounds. The first can be disposed of quickly. Merck claims that the GAO demand for Merck's records was prompted by the prodding of individual Senators who sought this "headline-grabbing" information for their own ends.[5] Speculation about Senatorial prodding or GAO's plans to leak confidential information to the media,[6] however, is irrelevant if the Comptroller

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[5] Reply Brief for Appellant Merck (Merck Reply Brief) at 8; see Brief for Appellant Merck (Merck Brief) at 18. It is undisputed that the impetus for GAO's inquiry originated in January, 1971, during hearings on the status of competition in the pharmaceutical industry before the Senate Select Committee on Small Business, Monopoly Subcommittee. At hearings in May, 1972, Senator Nelson, subcommittee chair, urged the Comptroller General to obtain "production costs respecting drugs" from pharmaceutical manufacturers. *Competitive Problems in the Drug Industry: Hearings Before the Subcommittee on Monopoly of the Senate Select Committee on Small Business*, 92d Cong., 2d Sess. 8573 (1972). The Comptroller General responded that he doubted whether meaningful conclusions could be drawn on the basis of individual drugs, and would prefer an industry-wide study "of total sales to the Government on negotiated contracts." *Id.* at 8577. In late 1972, GAO approached the Pharmaceutical Manufacturers Association and suggested the voluntary study discussed in note 3 *supra*. The voluntary participation of the drug companies allegedly broke down because GAO sought access to "sensitive cost data" and refused to give adequate assurances of confidentiality. Merck Brief at 4, 9. *But see* note 6 *infra*.

[6] Merck concedes that GAO "was prepared to give written assurances of confidentiality to the companies" in 1974. Merck Brief at 10. The district court added protective conditions to its order granting the government access to certain Merck cost data. J.A. 518-19.

General otherwise has a legitimate purpose for making the demand for access at issue here.[7] Our inquiry must focus on whether the Comptroller General's request was within the scope of his authority under the statutes. It is to that question we now turn.

A. *The Basis for GAO's Request*

Merck argues that GAO has no legitimate claim for access to Merck's records because GAO has not alleged any possibility of fraud, corruption, or the need to audit Merck's books. The Comptroller General is not authorized to demand access to contractor records simply to gather data for an industry-wide economic study, Merck claims, and this is said to be the aim of the GAO's demand.[8] In Merck's analysis, the access statutes were only

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[7] *See, e.g., United States v. LaSalle National Bank*, 437 U.S. 298, 316 (1978) (error to deny enforcement of IRS summons simply on basis of agent's personal intent); *McCray v. United States*, 195 U.S. 27, 56 (1904) (judiciary may not restrain the exercise of lawful power on the assumption that a wrongful purpose has caused the power to be exerted); *Lynn v. Biderman*, 536 F.2d 820, 826 (9th Cir.), *cert. denied*, 429 U.S. 920 (1976) ("It is not . . . a ground to deny enforcement of a subpoena that it is being employed for a wrongful purpose if there is also a legitimate purpose for the subpoena."). *Cf. United States v. O'Brien*, 391 U.S. 367, 383 (1968) (Supreme Court will not strike down an otherwise constitutional statute on the basis of allegedly illicit legislative motives for passing it).

[8] Merck notes the admission by Gregory J. Ahart, Director, Human Resources Division, that GAO has no specific reason to believe that Merck made excessive or unreasonable profits on any of the four contracts in question. J.A. 216. But the same witness also explained that "it is impossible to describe the types of recommendations that might be made" as a result of GAO's study, J.A. 242, and that "there is a range of possibilities of some modification on the basic procurement statutes." J.A. 243. The government's stated purpose for the access demand is "to review contract pricing by the Govern-

meant to apply in situations where allegations of fraud or illegality suggested that it would be desirable to conduct an audit of a specific contract. But the access demands may not be made merely to let GAO "conduct broad-ranging and ill-defined studies of the general adequacy of government procurement procedures." Merck Brief at 53.

This contention is not new.[9] A variety of sources are said to show that the access provision was intended "*solely* to provide a method to discover fraudulent activities," [10] or to serve "as a deterrent to improper conduct by government procurement officers," [11] or to apply only to situations in which there was "reason to suspect fraud

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ment's suppliers, including plaintiff, of drug items to determine the adequacy of the protection afforded the Government by the negotiation techniques used by the procuring agencies." Defendant's Response to Plaintiff's Second Set of Interrogatories, J.A. at 146.

[9] *See, e.g., United States v. Abbott Laboratories*, 597 F.2d 672, 674 (7th Cir. 1979); *Eli Lilly & Co. v. Staats*, 574 F.2d 904, 908 (7th Cir.), *cert. denied*, 439 U.S. 959 (1978); *Smith-Kline Corp. v. Staats*, 483 F. Supp. 712, 718 (E.D. Pa.), *appeal pending* No. 80-1464 (3d Cir. Mar. 19, 1980), *conditional petition for cert. before judgment denied*, —— U.S. ——, 101 S.Ct. 619 (1980); *Bristol Laboratories Div. of Bristol-Myers Co. v. Staats*, 428 F. Supp. 1388, 1390 (S.D.N.Y. 1977), *aff'd*, 620 F.2d 17 (2d Cir. 1980), *aff'd by evenly divided court*, —— U.S. ——, 101 S. Ct. 2037 (1981).

[10] Note, *Government Contracts: Contractor's Obligation to Allow Examination of Records Under 10 U.S.C. § 2313(b)*, 72 DICK L. REV. 687, 691 (1968) (emphasis added in Merck's Brief at 53). *But see id.* at 691 (possibility that Congress sought to improve general procurement techniques and "there is nothing in the Act specifically negating this idea . . . .")

[11] Merck Brief at 31 (analyzing the remarks of Rep. Hardy discussed *infra*).

or bad faith or illegality."[12] Merck emphasizes repeatedly that Congress had a "single and limited purpose," which was "to protect the government from fraud and other abuses." Merck Reply Brief at 26; *see id.* at 4, 14, 28. "[O]nly the suspicion of fraud or other improprieties" could trigger the access clause, *id.* at 27, because "the debates leave no room for doubt as to the limited anti-fraud purpose of the acces. statute." *Id.* at 29. These would be persuasive claims if they were supported by the legislative history. They grossly overstate that history, however, and it is time to dispatch the contention once and for all.

It is true that Representative Hardy, sponsor of the access-to-records legislation,[13] explained that his "main purpose" in introducing the bill was to deter "improprieties in the negotiation of Government contracts." 97 CONG. REC. 13198 (1951). Representative Hardy, however, intended the clause to do far more than combat or deter fraud. He spoke of "excessive" contract prices, "wastefulness in the negotiation of contracts," and the need for "every reasonable safeguard against waste and extravagance." *Id.* These comments convey concerns that go far beyond the "limited anti-fraud purpose" asserted by Merck. They show that Congress was particularly concerned about the general adequacy of government procurement techniques and not simply illegalities or frauds. Early in his explanation of the benefits of the access legislation, for example, Representative Hardy spelled out precisely the goal of improving procurement methods that Merck rejects:

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[12] 97 CONG. REC. 13198 (Rep. Hardy) (citing one example in which GAO could profitably use proposed access authority).

[13] A sponsor's statement of purpose is generally regarded as a persuasive indication of congressional intent. *See, e.g., Federal Energy Adm. v. Algonquin SNG, Inc.*, 426 U.S. 548, 564 (1976); *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 394-95 (1951).

> Under conditions as they now exist, competitive bidding has little or no effect upon contracts which are negotiated without advertising. As a result, when a contract is being negotiated, here is a typical illustration of what usually happens: A contractor with years of experience comes to the conference table accompanied by a highly competent accountant and equally competent lawyer. The Government representative on the other side of the table will, in a great majority of cases, be at a tremendous disadvantage, from the standpoint of both training and experience, *no matter how conscientious and honest he may be. So, aside from any intentional liberality on the part of the Government contracting officer, there is every chance in the world that the Government will come out on the short end of the deal.* This bill would at least enable the agent of the Congress to check the transaction, both from the Government records and the contractors' books.

Id. (emphasis added). Representative Hardy obviously sought to improve the governmental procurement system as a whole by equalizing the relationship between more experienced contractors and government representatives, who were otherwise "at a tremendous disadvantage," no matter how conscientious and honest they might be.[14] The access-to-records clause, by shedding light where none had been cast before, would reduce the number of times that the United States "will come out on the short end of the deal."

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[14] Indeed, Merck's own account of the negotiations here suggests the possibility that the government operated under "a tremendous disadvantage." Merck admits that "[t]here was no actual negotiation of the price prior to any of the awards," Merck Brief at 14, and that "no terms in any of the contracts were the result of negotiations between the parties. . . . In each case, Merck was asked to submit a bid for specified pharmaceuticals, and in each case the Merck bid was accepted by the government purchasing officer, without negotiation." Merck Reply Brief at 11 (citation omitted).

Other statements also demonstrate the true tenor of congressional concerns. Representative Hardy continued his explanation of the access bill by suggesting two hypothetical situations to which the clause would apply. In the first, a contractor charged the government for a much greater amount of "overhead" than it asked under a private contract for the same work. "[I]t would then obviously be desirable for the General Accounting Office to look behind the rate which had been established." *Id.* Should GAO find that "the rates were excessive," Representative Hardy explained, it would then be able to bring the facts to the attention of contracting authorities. *Id.* In the second "vivid example of how this authority would enable the GAO to do an effective job," Representative Hardy referred to an earlier congressional investigation into government procurement of automobile parts:

> We found one situation where the Government was buying parts from an automobile dealer who, in turn, was getting them from a parts distributor who, in turn, was getting them from a small tool shop. Naturally, the price paid by the Government included profits upon profits and completely wasteful administrative and handling costs. *It would be difficult, if not impossible, for GAO to detect such a situation without the right afforded in this bill.*

Id. (emphasis added). There is no implication in the statements about either hypothetical that the private contractors had acted fraudulently or illegally. Representative Hardy's access legislation was designed to uncover inefficient procurement methods as well as misfeasance, and Congress expected the access clause to reveal much more than "fraud." Moreover, the second example effectively refutes Merck's suggestion that the government must allege or suspect procurement abuses before the access clause can be invoked. Merck Brief at 14, 33. Representative Hardy's example is one in which

it would be impossible for GAO to detect waste without the authority to examine contractor records at will. Had Congress intended GAO to use the access clause only when it had suspicions of wrongdoing, Representative Hardy would surely have spoken of the difficulty for GAO "to investigate" that situation rather than the ability of GAO "to detect" it.

Several exchanges in the debates which followed Representative Hardy's introduction of the access-to-records legislation also indicate that Merck's reading of that legislation is woefully narrow. When Representative Mills suggested how useful the bill might be in investigating potentially fraudulent situations, Representative Hardy responded emphatically:

> The gentleman is right, with this exception that I think should be clearly understood, *that there are a lot of other situations besides those involving fraud which might be uncovered.*

97 CONG. REC. 13199 (1951) (emphasis added). Representative Hardy also had the following exchange with Representative Hoffman:

> Mr. HOFFMAN. The whole thing arises out of the belief . . . that the Federal employees who negotiate these contracts are no match for the people on the other end of the deal, those who negotiate for private enterprise. It that not right? That is what gives rise to this?
>
> Mr. HARDY. What is the gentleman's question?
>
> Mr. HOFFMAN. This bill is based upon the thought that the Federal employees who negotiate these contracts are no match for the people who represented private corporations or individuals?
>
> Mr. HARDY. I think that is one factor.

Id. at 13377.

Congress thus anticipated that the access-to-records legislation would lead to general improvement in the gov-

ernment's procurement system simply because it would equalize the relationship between agents of the United States and private contractors. Not surprisingly, this is also a long-standing interpretation by GAO:

> The right of access by GAO to records of costs of production is not limited to that necessary to determine whether the contracts were performed in accordance with their terms and whether the contracting officer had been defrauded or misled in entering into the contracts.

115 CONG. REC. 25801 (1969) (GAO memorandum reprinted at request of Senator Proxmire).[15] In the instant case, the Comptroller General has explained that the request for Merck's records is necessary "to determine the adequacy of the protection afforded the Government by the negotiating techniques used by the procuring agencies." Memorandum and Order, Aug. 12, 1977, J.A. 509. This purpose is within the scope of his lawful authority, for it puts the access legislation to exactly the sort of use for which Congress intended it.

B. *The Focus of GAO's Request*

Merck's third challenge to the applicability of the access clause is based on the nature of the contracts at

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[15] *Cf. Comptroller General Reports to Congress on Audits of Defense Contracts: Hearings Before the Military Operations Subcommittee of the House Committee on Government Operations*, 89th Cong., 1st Sess. 147 (1965) (statement of Robert Keller) ("Congress intended the GAO to examine the books and records of the contractor to make certain that the Government was getting a fair deal out of negotiated contracts"). Merck's narrower reading of the legislative history stems in part from understanding the word "audit" in the narrow, technical sense of to "check the books." Merck Brief at 32 (quoting 97 CONG. REC. 13200 (1951) (remarks of Rep. Riehlman)). Representative Hardy, however, used the term in the more general sense of "to inspect the pertinent books and records . . . ." 97 CONG. REC. 13197.

issue. Because these contracts are not "cost-based," and were negotiated without any reference to Merck's costs, Merck argues that its cost records cannot be relevant to the prices paid by the government or "directly pertinent" to the negotiation or performance of the contracts. Merck Brief at 63. The United States did not ask for any cost data or estimates from Merck when it negotiated these fixed-price contracts, and Merck did not volunteer or submit any such data or estimates during the negotiations. As a result, the company says, its cost data simply do not involve "transactions related to such contracts." *Id.*

This contention is deceptively appealing, but the legislative history provides no support for limiting the access-to-records clause to contracts that are "cost-based" or negotiated with reference to costs. It is true that the access-to-records legislation originated during the Korean War, when inflation and changes in demand for raw materials threatened to force many government contractors with fixed-price contracts into default. These pressures convinced Congress to give the president emergency authority to modify existing contracts in January, 1951,[16] and the access-to-records clause was a concomitant measure to ensure that contractors not take advantage of modifications under the emergency authority.[17] But the

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[16] Act of January 12, 1951, 64 Stat. 1257. Similar authority had been granted the president during World War II by the First War Powers Act of 1941, Pub. L. No. 77-593, 55 Stat. 838.

[17] Representative Celler described the Hardy amendment as "a Damoclean sword that will hang over the heads of the contractors whose contracts are changed. The amendment will give power to the General Accounting Office to go into the books and delve into the records of these contractors who have been relieved to determine whether or not there is fraud

fact that a specific concern provides the initial impetus for the passage of reform legislation will not necessarily defeat the broader application of that legislation simply because the initial stimulus disappears. Although Congress clearly regarded contracts negotiated without advertising as extraordinary measures, often necessitated by wartime pressures,[18] Congress explicitly wanted the clause to apply to *all* contracts negotiated without advertising. It is a far leap from this history to the conclusion that application of the access clause depends on whether representations about costs are made during the negotiation, or to the claim that the clause may apply to cost-plus contracts but not those negotiated in other ways. *See* Merck Brief at 64, 72 n.28.

Moreover, the legislative saga of the access-to-records clause did not end with the emergency grant of wartime renegotiation authority. The January statute was limited by its terms to the duration of the national emergency declared on December 16, 1950, and was to expire in any event after eighteen months. 64 Stat. at 1258. But the present and more permanent version of the access-to-records clause was proposed by Representative Hardy in October, 1951, after he learned that procurement officers were negotiating contract modifications under the permanent procurement statutes rather than the January amendments to the First War Powers Act, in order "to plug this loophole." 97 CONG. REC. 13198

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or overreaching or whether they have done anything untoward, in which event reports will be made and suitable action may be taken." 96 CONG. REC. 17123 (1951).

[18] *See* 97 CONG. REC. 13198 (Rep. Hardy) ("Authority for negotiating all types of contracts without advertising has not always been available to Government procurement officers. Normal peacetime procedures generally require competitive bidding, but during times of emergency procurement by negotiation becomes necessary"); *id.* at 13199 (Rep. Hardy) ("In normal times most contracts are advertised.").

(1951). Merck argues that the temporary duration of the January legislation shows that the October legislation could not have been intended to allow "generalized studies of the operation of the procurement system." Merck Brief at 26. But this argument fails to take account of the fact that the October legislation had an indefinite duration and was to apply to two permanent procurement statutes.

Merck's confusion about the relevance of costs to the applicability of the access clause is understandable because it can be traced to Merck's argument that the access legislation was designed merely to achieve "a limited anti-fraud purpose." Were that correct, it might follow that legislation to deter fraudulent reporting of costs should not apply where no representation about costs are made at all. But the government's purpose behind this access legislation was much broader; Congress *was* concerned about general improvements in the procurement system. There is compelling reason to think that Congress saw as much reason to have access to cost records for contracts negotiated without regard to costs as for contracts based expressly on cost, perhaps even more.

This interpretation of the access legislation is hardly new.[19] Every court to hear the question has held that

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[19] Moreover, the government argues that Merck must have realized the relevance of its costs, even though the contract was negotiated without regard to costs, from the nature of the executed contracts. Brief for Appellee United States (Government Brief) at 18-20. The contracts also included a clause requiring Merck to include in all subcontracts a provision to the effect that the subcontractor also agreed to give access to the Comptroller General. J.A. 23-24. The express requirement concerning access to subcontractors' records is manifestly a cost and pricing item, and should have made Merck aware that cost records would be considered pertinent to its negotiated, fixed-price contract.

the access-to-records clause gives the government the right to examine cost data even when the contracts are negotiated without party representations concerning costs. *Hewlett-Packard Co. v. United States*, 385 F.2d 1013 (9th Cir. 1967), *cert. denied*, 390 U.S. 988 (1968), involved GAO efforts to examine cost data for equipment sold under several fixed-price contracts. Although production costs were not taken into consideration in negotiating the contracts in question, the court said, it was clear that the subject matter of the contracts was the procurement of described property by the government.

> Production costs directly pertain to that subject matter, because if out of line with the contract price the contract may have been an inappropriate means of meeting this particular procurement need of the Government. While this appraisal could not affect these particular contracts, it could lead to the use of other methods of meeting future procurement needs.

Id. at 1016. In *Eli Lilly & Co. v. Staats*, 574 F.2d 904 (7th Cir.), *cert. denied*, 439 U.S. 959 (1978), the court rejected the drug company's argument to the contrary:

> Such an interpretation might be reasonable if the statutory standard were that the information must be "directly pertinent" to the negotiation, but the standard is "directly pertinent" to the contract and plaintiff offers no reason to suppose that there would be a reason to negotiate about each item that might have a significant effect on the seller's cost or performance.

Id. at 914.[20]

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[20] The Seventh Circuit followed its *Lilly* holding in *United States v. Abbott Laboratories*, 597 F.2d 672, 674 (7th Cir. 1979). This issue was not involved in *Bristol Laboratories Division of Bristol-Myers Co. v. Staats*, 428 F. Supp. 1388, 1391 (S.D.N.Y. 1977), *aff'd*, 620 F.2d 17 (2d. Cir. 1980), *aff'd by an evenly divided court*, —— U.S. ——, 101 S. Ct. 2037 (1981), because the company conceded the applicability

The foregoing discussion also demonstrates the unpersuasiveness of Merck's arguments by analogy to other procurement acts. Merck asks that we interpret the access clause in light of the "broader structure of government procurement fashioned by Congress." Merck Brief at 64. This structure includes the Renegotiation Act of 1951, Pub. L. No. 82-9, 65 Stat. 7, as amended in 1954, Pub. L. No. 83-764, 68 Stat. 1116, and the 1962 Truth-in-Negotiations Act, Pub. L. No. 87-653, 76 Stat. 528. Under the Renegotiation Act, contractors are generally required to permit audits of their books and records so that the government can detect and recover excess profits. The 1954 amendments exempted from this process those contracts involving "standard commercial items," 50 U.S.C. App. §§ 1216(e)(1)(A) and (4)(B). The government concedes that the Merck contracts in this case involve standard commercial items and thus are exempt from the reporting requirements of the Renegotiation Act, and Merck argues that the access clause should be read no more broadly. Merck Brief at 67. Similarly, under the Truth-in-Negotiation Act, contractors need not submit actual or estimated cost and pricing data during the negotiation process when the contract price is based on the established catalog price for a standard commercial item sold in substantial quantities to the general public. 10 U.S.C. § 2306(f).[21] Merck

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of the access clause to its fixed-price contracts. The issue was also not directly presented in *SmithKline Corp. v. Staats*, 483 F. Supp. 712 (E.D. Pa. 1980), *appeal pending* No. 80-1464 (3d Cir. Mar. 19, 1980), *conditional petition for certiorari before judgment denied*, December 8, 1980, —— U.S. ——, 101 S. Ct. 619 (1980).

[21] This section was amended in 1968 to give the Defense Department authority to examine "all books, records, documents, and other data of the contractor or subcontractor related to the negotiation, pricing or performance of the contract . . . ." Pub. L. No. 90-512, 82 Stat. 863 (1968), codified at 10 U.S.C. § 2306(f) (1980).

argues that the products sold under the contracts at issue here are standard commercial items sold at or below the established catalog price. It urges that the cost data that Congress has held to be irrelevant under the Truth-in-Negotiation Act should be found equally irrelevant under the access-to-records clause.

These arguments prove too much. If the subsequent procurement legislation is of the broad sweep Merck supposes, it renders the 1951 access-to records legislation redundant. Yet it is a canon of statutory construction that we are not to assume the redundancy of statutes, if they can be construed to be independently meaningful.[22] Furthermore, the later provisions illustrate that Congress could easily have drafted a more narrow access provision in 1951, or any later time, had it chosen to do so. *See Hewlett-Packard v. United States*, 385 F.2d at 1016 ("if such a limited scope of examination had been intended by Congress it would have found the means to so indicate"); *Eli Lilly & Co. v. Staats*, 574 F.2d at 916 ("Since Congress in the Renegotiation Act demonstrated its ability to draft a specific exemption provision, its failure to do so in the access-to-records legislation indicates that no such exemption was intended.").

Most importantly, however, Merck's arguments from these unrelated procurement statutes are unconvincing because their premise is erroneous. Essentially, Merck argues that it is pointless for the United States to inquire about Merck's costs because Merck is "market-oriented" and sells its products to the government and the public at the same "market price," thus proving that the instant contracts are ones "in which the reasonable-

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[22] Moreover, the Truth-in-Negotiation Act exemption is merely permissive, not mandatory. *Sperry Flight Systems Div. of Sperry Rand Corp. v. United States*, 548 F.2d 915, 920-21 (Ct. Cl. 1977) (statute says cost data sometimes "need not" be submitted, not "shall not" be submitted, so demand for data upheld).

ness of prices has been assured by competitive market forces." Merck Reply Brief at 41. Merck's assumptions about the market may indeed be true, but then again they may not. The situation can easily be imagined in which a number of companies do business with the government at an established catalog price, and yet in which the government is badly overcharged because an absence of truly competitive market forces permits oligopolistic pricing.[23] The fact that products are "standard commercial items," or even that they are sold in substantial quantities to the public, does not necessarily determine whether the market for them is truly competitive. No single purchaser of drugs is anywhere near as large or as non-competitively situated as is the United States government. Moreover, even if the market is competitive, why should not the United States (which is probably the largest single purchaser of some of these drug items) receive a measure for quantity discounting?

Recognition of this fact is singularly important. It is too little appreciated that government, in a number of ways, may often require far greater protection in the marketplace than private individuals. The manufacturer who sells to a retailer must hold down his prices or risk the possibility that the retailer will be forced out of business, thereby killing the proverbial goose with the

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[23] *See, e.g.*, 2 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 404 (1980) (basic economic model of oligopoly as collective but non-collusive "monopolization"). *See* note 5 *supra* (original interest in pharmaceutical industry's costs grew out of hearings on competitive problems before Subcommittee on Monopoly of the Senate Select Committee on Small Business). *Cf.* S. REP. No. 643, 83 Cong., 1st Sess. 4 (1953) (exemption in Renegotiation Act for "standard commercial items" based on fact that cost and pricing experience had already been acquired and prices made in a competitive market, "in most cases").

golden eggs. Unfortunately, when government is the buyer, no such scruples need depress the prices that contractors can charge. Seldom, and almost never for financial reasons, do governments 'go out of business.' Opportunities for fraud and corruption in government contracting have long been obvious; the inherent non-corrupt, non-fraudulent disadvantages that government often has in dealing with private contractors are only beginning to be understood. The very size of government purchases, and the necessity thereof, may make the traditional marketplace shields ineffective. In this era of cost-overrun scandals, it is sometimes forgotten that Congress devised the cost-plus contract as a major reform of its procurement methods, which once depended on negotiations without regard to costs that left the government "at a tremendous disadvantage" vis-a-vis the private contractor. The Hardy bill was designed to reduce this inequality by providing government with data that could enhance its procurement practices, thereby fighting wastefulness as well as fraud. There is no reason to think that Congress decided the reforms should not apply simply because private contractors were so much more sophisticated than the government that they could manage to avoid discussing their costs entirely. Congress expected to protect the government in exactly the sort of situation now presented, and the district court correctly found that the access provision applies to the Merck contracts at issue here.

II. Proper Scope of the Access Clause

The second question of statutory interpretation raised by this dispute, and the one on which Merck prevailed below, is the scope of the access-to-records clause when that clause is properly invoked. The trial court held that the Comptroller General had a right of access to data on Merck's

> manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision), manufacturing overhead (including plant administration, production planning, warehousing, utilities and security), royalty expenses, and delivery costs . . . .

Judgment and Order of January 24, 1979, J.A. 518. The court limited the government's access, however, by ordering

> that defendant Comptroller General shall not demand access to books, documents, papers, or records with respect to research and development, marketing and promotion, distribution, and administration (except to the extent such data may be included in the cost items listed above) . . . .

Id. For the reasons stated in Part I *supra*, and in recognition of the special economic structure of the pharmaceutical industry, I think we have an obligation to review this holding and to reverse it.

The trial court's ruling on this point can be said to differentiate between Merck's "direct costs" and "indirect costs." The trial court granted access to data on "direct costs," such as manufacturing and labor expenses, but denied access to data on "indirect costs" such as research, development, promotion, and distribution.[24] Initially, this holding appears entirely reasonable; it is an attempt, in the government's words, to "split the baby." Government Brief at 10, 28. On closer analysis, however,

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[24] This framework appears to correspond to Merck's distinction between its "allocated" and "unallocated" costs. Merck Brief at 70-71. There may be a crucial difference between "indirect" and "unallocated" costs, of course, if some indirect costs can be allocated. Merck implies that all indirect costs are unallocable, *id.* at 72, and claims that no generally accepted accounting principles permit allocation of indirect costs such as research. *But see* notes 31-33 and accompanying text *infra*.

it seems inescapable that this holding fails to give adequate consideration to the congressional purpose in enacting the access-to-records clause. If the access legislation was in fact meant to equalize the relationship between the government and private contractors, *see* Part I *supra*, then the trial court's narrow reading of the clause in this case utterly fails to advance that purpose because of the special characteristics of the pharmaceutical industry.

The Comptroller General asserts that the "direct costs" of manufacture in the pharmaceutical industry, such as labor and raw materials, may constitute an extraordinarily small part of the product price—less than nine percent. Government Brief at 25; *see Eli Lilly & Co. v. Staats*, 574 F.2d at 913-14. The remainder of drug revenues may go to "indirect costs," such as research, development, promotion, and distribution, as well as taxes and profits. In short, the "indirect costs" of the pharmaceutical industry may be ten times the size of its "direct costs," [25] and denial of the government's access to the preponderance of this cost data effectively defeats the purpose of the access provision. Improvement of procurement techniques is impossible if the government cannot get a fair idea of the industry with which it negotiates.

Merck argues that giving the United States access to data on its "indirect costs" would constitute a failure to apply the "directly pertinent" limitation in the access clause. It argues, in effect, that although "direct costs"

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[25] Merck appears to concede as much. *E.g.*, Merck Brief at 71 ("costs of research and development . . . tend to be the largest items of overall expenses at pharmaceutical companies"); Merck Reply Brief at 6 ("probably true that research and development costs . . . tend to be a higher percentage of total expenses in the pharmaceutical industry than in most other industries").

might be "directly pertinent," "indirect costs" cannot be directly pertinent by definition. The similarity of these phrases, though seductive, cannot substitute for analysis. The lower court's decision approving this distinction [26] was erroneous on two main grounds.

First, the narrow reading of the clause defies reason. The four contracts involved here between Merck and the United States concerned the supply of pharmaceutical products for a total price of more than $2,800,000. J.A. 34-37. If Merck's "direct costs" are only nine percent of this figure, and if Congress' grant of access is limited to direct costs, the lower court's decision precludes governmental access to cost data behind the remaining charges of $2,548,000. The implications of such a limited interpretation of the access clause become even more significant when one considers the extent of the federal government's contractual business with drug companies. Federal expenditures for pharmaceuticals exceed one billion dollars annually. J.A. 366. The narrow reading of the district court, if generally followed, would preclude government access to data concerning the underlying costs of more than $900,000,000 in pharmaceutical purchases annually. It should be obvious that Merck's "indirect costs" are "directly pertinent" to procurement transactions concerning these government contracts, for otherwise the legislative purpose of reducing waste in government procurement would be undermined severely.

Fortunately for the public fisc, the district court's reasoning has been followed by only one circuit. *Staats v. Bristol Laboratories*, 620 F.2d 17 (2d Cir. 1980). The Seventh Circuit, on the other hand, has consistently held that such costs as research and development "have a logical, causal and consequential relationship to a portion

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[26] J.A. 512. The lower court explicitly followed the holding of *Bristol*, 428 F. Supp. at 1390.

of the price of the products purchased by the Government." *Eli Lilly & Co. v. Staats*, 574 F.2d at 914.

> Although it might be possible to argue in other industries that costs such as research and development have such a small impact that they are not "directly pertinent" to the contract and its price, research and other costs not immediately attributable to one product form such a large portion of the costs of a pharmaceutical product that their import to such a contract seems inescapable.

Id. at 913-14. The same conclusion was reached in *SmithKline Corp. v. Staats*, 483 F. Supp. at 722 (E.D. Pa. 1980), and arguably by the Ninth Circuit in *Hewlett-Packard Co. v. United States*, 385 F.2d at 1016 (9th Cir. 1967).[27]

The lower court's decision is erroneous for a second reason. Its ruling should have been restricted to an analysis of the congressional purpose in enacting the access legislation, but embarked instead on a misguided attempt to find "a realistic interpretation of the intent

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[27] Later decisions have disagreed over the *Hewlett-Packard* holding on this point. The contract in that case concerned electronic equipment for which direct labor and material costs undoubtedly made up the bulk of the price, but the trial court found the government entitled to inspect data on Hewlett-Packard's "costs of direct material, direct labor *and overhead costs*" in producing the items furnished under the contracts. 385 F.2d at 1016 (emphasis added). The Seventh Circuit subscribed to a broad reading of this order because it "included overhead costs, a type of cost that is not always assignable to individual products, and because the Ninth Circuit's opinion, which emphasized the appropriateness of inquiry into the procurement process as a whole, was not limited to disclosure of the specific costs requested by the Comptroller General in that particular case." *Lilly*, 574 F.2d at 913. The Second Circuit in *Bristol*, on the other hand, read the decision in *Hewlett-Packard* as limited to production costs only and therefore as "of no positive aid in resolving the instant controversy," 428 F. Supp. at 1391.

of the parties. . . ." J.A. at 512. This emphasis on the parties' intent misapprehends the applicable law, for although the access clause was included in Merck's contracts, it was required in those contracts by statute. When a clause is included by reason of congressional command, rather than as the result of contractual negotiations, the proper focus of inquiry is the intent of Congress.[28] Merck did business with the government voluntarily, and thereby accepted the access clause as a precondition to doing business with the government.[29] The access clause is of standardized, nationwide application; there was no discussion or negotiation as to inclusion of the provision or its terms. Merck acknowledges:

> Indeed the standard-form clauses were among the various provisions that were simply incorporated by reference and not even made a physical part of the contracts. J.A. 74, 84-5. Not surprisingly, there was never any actual discussion or negotiation about the access clauses or their scope. *See* J.A. 88-9.

Merck Reply Brief at 2. Attempts to analyze the "intent" of the parties to such contracts must be considered dubious. "Obligatory Congressional enactments are held to govern federal contracts because there is a need to guard the dominant legislative policy against *ad hoc* encroachment

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[28] The parties do not dispute this. Merck agrees that the contract clause "merely mirrored the access statute," and thus "it is congressional intent that is determinative . . . . [I]t remains Congress's purpose that is controlling, at least where the parties to the contract did not expressly agree to alter the statutorily prescribed right of access." Merck Reply Brief at 10. The government also agrees: "Since the contract here involved is required by statute, there can, of course, be no issue as to bargaining as to the terms of the clauses . . . ." Government Brief at 20-21 n.12.

[29] *Cf. Almeida-Sanchez v. United States*, 413 U.S. 266, 271 (1973) ("The businessman in a regulated industry in effect consents to the restrictions placed upon him.").

or dispensation by the executive . . . ." *G.L. Christian & Associates v. United States*, 320 F.2d 345 (Ct. Cl.), *cert. denied*, 375 U.S. 954 (1963). This rule of deference to congressional intent is especially important in this case, in which the legislative history demonstrates the expectation of Congress that GAO access to cost data would equalize the relationship between government and contractor.[30]

Ultimately, Merck's position on this issue can be reduced to two rather plaintive arguments. First, Congress must have meant *something* when it added the word "directly" in front of the phrase "pertinent books, documents, papers, and records." This observation, while doubtless sensible, does not help Merck's case. The amendment to the access legislation was made on the House floor by Representative Hoffman, a critic of the measure, who explained that its purpose was "to limit the 'snooping' that may be carried on under this bill *which we do not have the votes to defeat.*" 97 CONG. REC. 13377 (emphasis added). But this word of limitation must be read in the context of the congressional debates and Representative Hoffman's understanding of the bill before his amendment was added. To Representative Hoffman, the access legislation "would let the GAO go into *everybody's* business and look it over if they just wanted to take a look at it. . . ." 97 CONG. REC. 13373. For example:

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[30] Even if the intent of the parties were relevant, Merck must be charged with knowledge that the government read the access clause broadly in light of *Hewlett-Packard*. Merck asks that we refuse to follow *Hewlett-Packard*, Merck Reply Brief at 4, but it is clear that Congress too knew the holding in that case and yet did not amend the access statute. See 115 CONG. REC. 25800 (1969) (GAO memorandum reporting *Hewlett-Packard* decision, reprinted at request of Senator Proxmire) (words "directly pertinent" in clause "were intended only to limit GAO's right of access to records pertaining to Government work as distinguished from non-government work.").

> If someone out in the country makes a contract for, as he said, an item which may be 10 percent of the total production, that under this bill, if it goes through, the GAO can send someone out there and go through the books, *not only with reference to that one item of 10 percent which went into production for the Government, but into all of his other business where that same item was used.*

97 CONG. REC. 13377 (emphasis added). In other words, Representative Hoffman feared not that the GAO would inspect the indirect costs behind production for the government, but that GAO would inspect the direct costs of production of all items that were ever used by the government, even when the production was not relevant to government procurement at all. Representative Hoffman's opinion of what was proper governmental access under the clause merely restated Representative Hardy's position, and thus the sponsor of the legislation said he had no objection to the proposed amendment offered by one of the bill's critics. 97 CONG. REC. 13377. The demand by the Comptroller General here for access to indirect cost data is thus entirely consistent with Representative Hoffman's amendment. The Comptroller General does not exceed the scope of the access clause envisioned by Congress, for he seeks only the data relevant to procurement by the government—but all of that data rather than a mere portion of it.

Merck's final argument is that it is unfair to let the definition of "directly pertinent" costs depend on the structure of different industries. Merck Reply Brief at 42-43. I believe Congress concluded exactly the opposite, and expected such open-ended phrases as "directly pertinent" to be applied in light of the particular facts and conditions of each government contract. Merck suggests that such flexibility would lead to "an absurd result" in the instant case, for GAO "would be entitled to examine a massively greater number of documents because fewer

are evidently pertinent." Merck Brief at 72. But this result is not absurd at all. The test of "directly pertinent" is not the number of documents an industry must furnish, or the relative burden of doing so, but whether those documents will assist the government to determine whether its negotiating practices sufficiently protect it from wasteful, fraudulent, or inefficient procurement practices. Merck notes that "there simply are no generally accepted accounting principles permitting allocation of these indirect costs in an accurate and meaningful manner to particular products or contracts, including those at issue in this case." *Id.* at 71. But this is exactly why Congress gave the Comptroller General a broad grant of authority. As the Ninth Circuit noted in *Eli Lilly & Co. v. Staats*:

> The mere fact that, as plaintiff asserts, it does not or even could not allocate costs such as research and development to an individual contract does not undercut the proposition that those costs are directly pertinent to an individual contract but merely indicates that they are directly pertinent to more than one individual contract.

574 F.2d at 914.[31] It will not do to let the difficulty of the task before GAO stand in the way of the congressional mandate that it be attempted.

Obviously, the government has no right to examine costs recovered exclusively from non-governmental contracts.[32] Moreover, governmental access should also be

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[31] *See*, Case Comment, *The Comptroller General's Authority to Examine the Private Business Records of Government Contractors: Eli Lilly & Co. v. Staats*, 92 HARV. L. REV. 1148, 1157 & nn. 67, 68 (1979) (*Lilly's* interpretation of "directly pertinent" is supported by the legislative history).

[32] *Eli Lilly & Co. v. Staats*, 574 F.2d at 918: "[N]o information need be produced relating to classes of costs that have no more than a *de minimis* impact on the price of a product purchased by the Government."

denied where Merck can show, through generally accepted accounting principles, that even its unallocated costs are minimally relevant to government contracts. But the burden of showing that such costs are irrelevant must fall on Merck because only Merck has all the data necessary to make such a showing. Indeed, Merck acknowledges that it has already undertaken a number of cost studies of these unallocated costs, an undertaking that seems somewhat surprising if these studies are as inaccurate and meaningless as Merck claims.[33] Unless the burden of showing that unallocated costs are not relevant to government contracts is imposed on the party that has the data, companies might avoid compliance under the access clause simply by refusing to allocate any of their costs to any of their products. Such a result would abort the purpose of the access-to-records legislation as adopted by Congress. The district court's order limiting the government's access to Merck's books and records should therefore be reversed.

CONCLUSION

One must come to statutes such as this with a pro-disclosure bias. The public business ought to be public; the government's right to know the costs incurred by its contractors is as important as the public's right to know

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[33] "Merck has, on occasion, performed 'profitability' studies of some of its product lines." Merck Reply Brief at 7. Merck refers to these studies as "the essentially arbitrary assumptions made by one company," and emphasizes that "there are no generally accepted accounting principles for compiling such studies." *Id.* But the fact that there is "no consistent methodology for these *ad hoc* internal studies" and " 'broad allocations,' " *id.* at 48, hardly shows that there is no point in trying to make such a study, as Merck's own efforts demonstrate. *But see* Note, *Eli Lilly & Co. v. Staats: An Undue Expansion of the GAO's Investigatory Power Under the Access to Records Statutes*, 74 NW. L. REV. 122, 132 (1979) (no need to allocate insignificant research costs).

the costs incurred by its government. As Representative Hardy said in 1951, noting that nine of every ten companies voluntarily opened their cost records to the government,

> this bill would affect that comparative few contractors who now refuse the agent of the Congress permission to see their records. It would be compulsory upon them. It seems logical to me to suppose that there is greater need for the GAO to see the records of those few who do not wish to make them available on a voluntary basis than it is to see the records of those who readily comply.

97 CONG. REC. 13197. Representative Hardy's view of the private sector may be unworldly, but it underlies the design of Congress in granting the GAO access to the books and records of those seeking to sell goods to the government. Moreover, there is absolutely no legally compelling basis on which to conclude that such access extends to the manufacturing but not to the research and development costs of pharmaceutical companies such as Merck.

The majority opinion embraces far too constrained an interpretation of the access-to-records clause. I believe that when the Supreme Court ultimately resolves the present split among the circuits, it will not impose a reading of the statute which makes the intent of Congress so diminutive. I dissent.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1980

No. 79-1435

MERCK & CO., INC., APPELLANT

v.

ELMER B. STAATS, COMPTROLLER, ET AL.

79-1438

MERCK & CO., INC.

v.

ELMER B. STAATS, COMPTROLLER, ET AL., APPELLANTS

Civil Action No. 74-1447

United States Court of Appeals
for the District of Columbia Circuit

FILED SEP 10 1981

GEORGE A. FISHER
CLERK

APPEALS FROM THE UNITED STATES DISTRICT
COURT FOR THE DISTRICT OF COLUMBIA

Before: TAMM, ROBB and MIKVA, *Circuit Judges*

JUDGMENT

These causes came on to be heard on the records on appeal from the United States District Court for the District of Columbia and were argued by counsel. On consideration of the foregoing, it is

ORDER AND ADJUDGED by this Court, that the judgment of the District Court is affirmed, pursuant to the District Court's memorandum opinion filed August 12, 1977, in accordance with the opinion of this Court filed herein this date.

Per Curiam
For the Court

GEORGE A. FISHER
Clerk

Date: September 10, 1981
Opinion Per Curiam
Opinion concurring in part and dissenting in part filed by Circuit Judge Mikva.

APPENDIX C

United States District Court
For The District of Columbia

MERCK & CO., INC., PLAINTIFF,

v.

ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES, DEFENDANT,

and

THE UNITED STATES OF AMERICA, Intervenor-Defendant

Civil Action No. 74–1447

Filed Aug 12, 1977

MEMORANDUM AND ORDER

This is an action in which plaintiff Merck & Co., Inc., a New Jersey corporation that manufactures, distributes, and sells pharmaceutical products, seeks a judgment declaring that defendant Comptroller General of the United States lacks authority to examine certain records pertaining to Merck's cost structure and corresponding injunctive relief. The Comptroller claims a right to review all of plaintiff's records relating to four contracts, negotiated without advertising, for sale of pharmaceutical products to the Department of Defense and the Veterans Administration. The right, both sides agree, derives from 10 U.S.C. § 2313 (6) and 41 U.S.C. § 254(c), which require that the following language appear in government contracts negotiated without advertising:

> The Contractor agrees that the Comptroller General . . . shall . . . have access to and the right to examine any directly pertinent books, documents, papers, and records of the Contractor involving transactions related to this contract.

Each of the four contracts involved in this case contains such a provision.

The dispute centers on the scope of the Comptroller Gen-

eral's authority. Merck contends that since the contract prices were not cost based, the records the Comptroller seeks to examine do not "directly pertain" to the prices paid by the Government, and therefore are not subject to disclosure. Also, Merck contends that the purpose of these contractual provisions is to enable the Government to ensure that the prices it pays are reasonable and appropriate. Here, says Merck, the Government has no such purpose in mind but seeks instead to gain access to Merck's records in order to conduct an economic survey of the pharmaceutical industry. Defendants see matters differently. They interpret the scope of the Comptroller's authority broadly, and they demand from Merck.

> all books, documents, papers, and other records directly pertinent to the contracts, which includes, but are not limited to (1) records of experienced labor costs including costs of direct materials, direct labor, overhead, and other pertinent corporate costs, (2) support for prices charged to the government, and (3) such other information as may be necessary for use to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government's interests.

Defendants contend that the "survey proposed by the Comptroller is being conducted *in order to determine the adequacy of protection afforded the Government by negotiating techniques used by the procuring agencies*," Reply Memorandum of the United States at 9 (emphasis in original); *see also* Ahart Affidavit, para. 13; that facilitation of such a determination was one of the primary purposes underlying 10 U.S.C. §2313(b) and 41 U.S.C. § 254 (c), *see e.g.*, H.R. 2574, 97 Cong. Record 13198 (Daily ed. Oct. 15, 1951); and that persuasive authority for broad construction of the contractual provisions exists in *Hewlett-Packard Company v. United States*, 385 F.2d 1013 (9th Cir.), *cert. denied*, 390 U.S. 988 (1967).

Hewlett-Packard, supra, is the sole decision by an appellate court that interprets the statutory language involved in this case. There Hewlett-Packard had entered into sev-

eral negotiated fixed-price contracts with the Department of the Air Force. As 10 U.S.C. § 2313 (b) commands, each of the contracts contained a standard access-to-records clause. After performance of the contract, representatives of the Comptroller General demanded from Hewlett-Packard all records

> relating to the pricing and cost of performance, support for prices charged to the Government, and such other necessary information which would permit such Representatives to review the reasonableness of the contract prices provided for in the aforesaid contracts.

385 F.2d at 1015. Although, as here, Hewlett-Packard claimed not to consider production costs in arriving at the terms and conditions of the contracts in question, *id.* at 1016, the Court of Appeals affirmed the trial court's determination that the Comptroller's demand was entirely lawful and appropriate. The court acknowledged that the words "directly pertinent to . . . transactions related to the contract" are words of limitation—that an access-to-records clause does not permit open-ended inspection. *Id.* at 1015–1016. The court went on to say, however, that

> the word "contract," as used in the statute is intended to have a broader meaning, embracing not only the specific terms and conditions of the agreement, but also the general subject matter. The subject matter of these four contracts is the procurement of described property by the Government.
>
> Production costs directly pertain to that subject matter, because if out of line with the contract price, the contract may have been an inappropriate means of meeting this particular procurement need of the Government. While this appraisal could not affect these particular contracts, it could lead to the use of other methods of meeting future procurement needs. Production costs involve transactions relating to the contract, because they encompass business arrangements made by the contractor in obtaining the materials, labor, facilities and the like required by it in fulfilling its commitment with reference to the subject matter of the contract.

Id. at 1016. Specifically, the Court of Appeals upheld the trial court's declaration that the company's costs of *direct material, direct labor and overhead in producing* the items furnished under the contracts are directly pertinent to those contracts and must be made available to the Comptroller. *Id.* at 1015.

I am satisfied that *Hewlett-Packard* accommodates governmental interest in supervising and controlling the procurement process in precisely the manner intended by Congress. *See* Senate Report 603, 82nd Congress, concerning Senate Bill 921; statement by Congressman Celler, 96 Cong. Rec. 17123, January 2, 1951. Also, I am satisfied that the survey proposed by the Comptroller in this case, *see* Ahart Affidavit, para. 11–13, will facilitate supervision of the procurement process and is within his authority. Hence I reject the restrictive approach to access-to-records clauses taken in *Eli Lilly and Co. v. Staats*, I P75–72–C (S.D. Inc. [sic] November 30, 1976), a post-*Hewlett-Packard* decision relied upon by plaintiff. However, I do find persuasive the further refinement of *Hewlett-Packard* in *Bristol Laboratories Division of Bristol-Myers Co. v. Staats*, 75 Civ. 1334 (S.D.N.Y. April 11, 1977), which, like *Eli Lilly, supra*, involved an access-to-records demand identical to the one at issue here. Comptroller access to records relating to manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision), manufacturing overhead (including plant administration, production planning, warehousing, utilities and security), royalty expenses, and delivery costs. *Bristol. supra*, Memorandum Order at 3. Bristol contended that data concerning research and development, marketing and promotion, distribution and administration (except to the extent such data relate to the cost items listed above) were too remote to be considered "directly pertinent" to its contracts with the Government. The court agreed with Bristol's position, stating:

> The specific list of items Bristol offers to make available ... appears to reflect a responsible and reasonable effort to distinguish "directly pertinent" matter within the meaning of the access to records clause. It represents a sensible point at which to draw the line.

Id. at 8. Particularly instructive is the court's observation that,

> Although the access to records clause has its origins in statute, it is nevertheless a contractual provision. We are thus confronted with the task of construing the contract, a task which turns on the intent and understanding of the parties regarding the import of the access to records clause at the time the contracts were entered. The government's position [which the court saw as open-ended] is particularly unrealistic when viewed in this light. It is inconceivable that Bristol, or any contracting firm, could have understood this clause to authorize the sweeping power of inspection claimed by the GAO.

Id. at 6–7. These principles, taken together with those enunciated in *Hewlett-Parkard*, have guided me in construing the contracts at issue in this case. The line drawn by the *Bristol* court appears to me a realistic interpretation of the intent of the parties in this case as well.

For these reasons it is this 11 day of August, 1977,

ORDERED, that the motions for summary judgment by defendant and defendant-intervenor are granted in part and denied in part as outlined below; and it is

FURTHER ORDERED, that plaintiff Merck and Co., Inc.'s motion for summary judgment is granted in part and denied in part as outlined below; and it is

FURTHER ORDERED, that the Comptroller General of the United States and his duly authorized representatives have the right to examine all books, documents, papers, or records directly pertaining to the pricing and cost of producing the items furnished by plaintiff Merck under the following contracts numbered: V797P–5077(C), DSA120–74–C–0680, DSA120–74–C–1813, and DSA120–73–D–2842, including manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision), manufacturing overhead (including plant administration, production planning, warehousing, utilities and security), royalty expenses, and delivery costs; and it is

FURTHER ORDERED, that defendant Comptroller General shall not demand access to books, documents, papers, or records with respect to research and development, marketing and promotion, distribution, and administration (except to the extent such data may be included in the cost items listed above); and it is

FURTHER ORDERED, that plaintiff Merck, its officers, agents, servants, attorneys, employees and all persons in active concert or participation with them who receive actual notice of an order by personal service or otherwise, are enjoined from preventing the duly authorized representatives of the Comptroller General of the United States from obtaining access to and examining records authorized above; and plaintiff Merck, including its officers and subordinates, is directed to have available on the premises of Merck, Rahway, New Jersey, and its other principal offices wherever located, such books and records at a time and date mutually agreed upon by the parties; and it is

FURTHER ORDERED, that this case be, and hereby is, dismissed.

/s/ WILLIAM B. BRYANT
Judge

APPENDIX D

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74–1447

Filed Jan 24, 1979

JAMES F. DAVEY, *Clerk*

MERCK & CO., INC., PLAINTIFF,

v.

ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES, DEFENDANT,

and

THE UNITED STATES OF AMERICA, INTERVENOR-DEFENDANT.

JUDGMENT AND ORDER

This matter is before the Court on the motion of plaintiff Merck & Co., Inc. [hereinafter "Merck"] to alter or amend the judgment pursuant to Rule 59(e) of the Federal Rules of Civil Procedure. Upon consideration of plaintiff's motion, the memoranda in support and opposition thereto, and the entire record in this action, it is this 23 day of January, 1979,

ORDERED, that the Plaintiff's Motion to Amend or Alter the Judgment is denied except to the extent it is granted in part in the following paragraphs; and it is

FURTHER ORDERED, that the judgment of this Court previously entered in this action on August 12, 1977, be amended to delete the grant of injunctive relief against Merck and to add provisions to protect the confidentiality of Merck's records to which the Comptroller General may obtain access under the judgment; and it is

FURTHER ORDERED, that the judgment of this Court on the motions for summary judgment submitted by plaintiff Merck, defendant Comptroller General of the United

States, and intervenor-defendant United States of America now read as follows:

ORDERED, that the motions for summary judgment by defendant and defendant-intervenor are granted in part and denied in part as outlined below; and it is

FURTHER ORDERED, that motion of plaintiff Merck and Co., Inc. for summary judgment is granted in part and denied in part as outlined below; and it is

FURTHER ORDERED, that the Comptroller General of the United States and his duly authorized representatives have the right to examine, on the premises of Merck, Rahway, New Jersey, and its other principal offices wherever located, at a time and date mutually agreed upon by the parties, all books, documents, papers, or records directly pertaining to the pricing and cost of producing the items furnished by plaintiff Merck under the following contracts numbered: V797P-5077(C), DSA120-74-C-0680, DSA120-74-C-1813, and DSA120-73-D-2842, including manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision), manufacturing overhead (including plant administration, production planning, warehousing, utilities and security), royalty expenses, and delivery costs; and it is

FURTHER ORDERED, that defendant Comptroller General shall not demand access to books, documents, papers, or records with respect to research and development, marketing and promotion, distribution, and administration (except to the extent such data may be included in the cost items listed above); and it is

FURTHER ORDERED, that every book, report, paper, record, and other document (all hereinafter referred to as "document"), designated as confidential by Merck or any of its divisions or subsidiaries and provided or otherwise made available to the Comptroller General or any of his successors, agents, employees, and subordinates (all hereinafter referred to as "the Comptroller General"), and every summary thereof and extract therefrom, and all data and information contained therein, including accountants' work

papers (all hereinafter referred to as "data"), shall be held in confidence and shall not be provided or otherwise made available by the Comptroller General to any person or agency outside the General Accounting Office except as provided in subparagraphs (a) and (b), below. No copies of Merck's documents shall be included in accountants' work papers without the approval of Merck.

Any document and data referred to in the above paragraph shall be used by the Comptroller General solely for the purpose of a contract study. Upon completion of that study, the Comptroller General shall immediately return to Merck all documents described in that paragraph. Any data in which Merck, any of its divisions or subsidiaries, or any product manufactured or sold by any of them are or may be directly or indirectly identified which the Comptroller General deems it necessary to retain shall be retained by the General Accounting Office and deposited with and maintained by the Comptroller General under security measures to be agreed upon by the parties. Access to such data by any person shall be permitted only upon written authorization of the Comptroller General, and as limited in the subparagraphs following next denominated (a) and (b).

(a) Any of the data referred to in the above paragraph may be published, provided to, or otherwise made available to a person or agency outside the General Accounting Office if the data are published, provided, or made available so that any direct or indirect identification of Merck, any of its divisions or subsidiaries, or any product manufactured or sold by any of them, is not reasonably possible. Merck shall be afforded a reasonable opportunity to examine and offer its comments regarding any data considered for release, including any report issued by the Comptroller General that includes such data, before release of the data or report.

(b) The Comptroller General may comply without regard to the limitations of this Order set forth above, with an official written request for any of the data referred to above submitted to him by either House of

Congress, or any committee of the House of Representatives or the Senate, or any joint committee of the two Houses, having jurisdiction over the subject matter of the study referred to in the Affidavit of Gregory J. Ahart filed in this action, to the extent authorized and directed by law. The Comptroller General will cause prompt notice of any such request to be given to Merck and to this Court at least seven calendar days prior to furnishing the data requested, and it is

FURTHER ORDERED, that the Comptroller General and the United States shall notify Merck promptly of any request for disclosure, subpoena *duces tecum*, civil action, or other order or application for an order seeking production, release, or disclosure of any data referred to above, and further agree to use their best efforts to protect the confidentiality of such data, except as provided above, including resort to appropriate judicial remedies and cooperation with Merck in such efforts, and it is

FURTHER ORDERED, that the Court shall retain jurisdiction to interpret and enforce the terms of this Judgment, upon application of any party, and it is

FURTHER ORDERED, that each party shall bear its own costs.

/s/ WILLIAM B. BRYANT
United States District Judge

Joint Appendix

Office - Supreme Court, U.S.
FILED
JUL 6 1982
ALEXANDER L. STEVAS,
CLERK

Nos. 81-1273 and 81-1472
(Consolidated)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

CHARLES A. BOWSHER, *et al.*,
Petitioners

v.

MERCK & CO., INC.

MERCK & CO., INC.,
Petitioner

v.

CHARLES A. BOWSHER, *et al.*

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

JOINT APPENDIX

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Petition in No. 81-1273 filed January 7, 1982
Petition in No. 81-1472 filed February 5, 1982
Petitions Granted April 19, 1982

JOINT APPENDIX

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1. Opinion of the United States Court of Appeals for the District of Columbia Circuit, dated September 10, 1981, in Nos. 79-1435 & 79-1438, *Merck & Co., Inc. v. Staats, et al.*—Previously reprinted as Appendix A, pp. 1a-32a, to the Petition for a Writ of Certiorari in No. 81-1273 (filed January 7, 1982).

2. Judgment of the United States Court of Appeals for the District of Columbia Circuit, filed September 10, 1981, in Nos. 79-1435 & 79-1438, *Merck & Co., Inc. v. Staats, et al.*—Previously reprinted as Appendix B, pp. 33a-34a, to the Petition for a Writ of Certiorari in No. 81-1273 (filed January 7, 1982).

3. Memorandum and Order of the United States District Court for the District of Columbia, filed August 12, 1977, in Civil Action No. 74-1447, *Merck & Co., Inc. v. Staats, et al.*—Previously reprinted as Appendix C, pp. 35a-40a, to the Petition for a Writ of Certiorari in No. 81-1273 (filed January 7, 1982).

4. Judgment and Order of the United States District Court for the District of Columbia, filed January 24, 1979, in Civil Action No. 74-1447, *Merck & Co., Inc. v. Staats, et al.*—Previously reprinted as Appendix D, pp. 41a-44a, to the Petition for a Writ of Certiorari in No. 81-1273 (filed January 7, 1982).

RELEVANT DOCKET ENTRIES

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

DATE	
1974	
Oct. 2	Complaint filed
Dec. 2	MOTION by United States of America to intervene as party-deft.
Dec. 16	MEMORANDUM by pltf. in opposition to the motion of the United States to intervene as party deft.
Dec. 24	REPLY by defts. to pltfs. opposition to motion of U.S. to intervene as a party deft.
1975	
Feb. 20	ORDER granting motion of United States to intervene as a party deft. (Signed 2-19-75 (N) Bryant, J.
Feb. 20	ANSWER by United States of America to complaint; counterclaim; appearance of David Epstein as attorney for deft.
Feb. 20	ANSWER of deft. #1 to the Complaint
Mar. 11	MOTION of pltf. for leave to file amended complaint
Mar. 11	ANSWER by pltf. to counterclaim of deft. #2
Apr. 2	MOTION of pltf. for leave to file an amended complaint granted. (FIAT) (N)
Apr. 2	AMENDED complaint
Apr. 2	ANSWER of deft. #2 to amended complaint
Apr. 2	ANSWER of deft. #1 to amended complaint
Apr. 23	MOTION of deft. #2 for summary judgment on its counterclaim against pltf.
May 22	INTERROGATORIES (first set) by pltf. to deft.
May 22	REQUEST (first) by pltf. to produce documents
June 4	MEMORANDUM of P&A's by pltf. in opposition to the motion of the United States of America, intervenor-deft., for summary judgment; * * *

DATE	
1975	
	statement; affidavit of T.J. Drygas; exhibits * * * affidavit of Philip H. Roy in opposition; exhibits * * *
June 20	OBJECTIONS by deft. and deft.-intervenor to pltfs. interrogatories
June 20	OBJECTIONS by deft. and deft.-intervenor to pltfs. request for production of documents
July 24	MOTION by pltf. to compel answer to interrogatories and production of documents by defts.
Sept. 10	OPPOSITION by defts. to motion of pltf. to compel answers to interrogatories and production of documents
1976	
Aug. 17	JOINT Report by the Parties
Aug. 31	ORDER filed 8-26-76 withdrawing pltfs. first set of interrogatories, pltfs. first request to produce, deft. and deft.-intervenor's objections to pltfs. interrogatories, deft. and deft.-intervenor's objections to pltfs. request to produce, pltfs. motion to compel of July 24, 1975, and defts. opposition to motion of pltf. to compel of Sept. 10, 1975; directing all parties to file and serve interrogatories, requests for admissions or to produce documents by September 16, 1976; parties to respond within 20 days; depositions to be completed within 20 days after receipt of responses to discovery requested; pltf. to reply to defts. motion for summary judgment and file cross-motion for summary judgment within 20 days after receipt of discovery requested or after receipt of last deposition; defts. to file brief 20 days later and pltf. to file reply within 10 days. (Signed 8-25-76) (N) Bryant, J.
Sept. 7	INTERROGATORIES by pltfs. (Second Set) to deft. and intervenor-deft.
Sept. 7	REQUEST by pltf. (Second) to produce documents
Sept. 14	FIRST set of interrogatories by deft. and intervenor deft. to pltf.
Sept. 27	RESPONSE by defts. to pltfs. second request to produce documents

DATE	
1976	
Sept. 27	RESPONSE by defts. to pltfs. second set of interrogatories
Oct. 8	RESPONSE by pltf. to deft. and intervenor-defts. first set of interrogatories "Under Seal"—sealed per order of Judge Bryant 10-8-76
Oct. 8	RESPONSE by pltf. to deft. and intervenor-defts. first set of interrogatories "Redacted Version"
Nov. 12	DEPOSITION of Gregory J. Ahart for the pltf.; Exhibits PA-1 thru PA-61 of pltfs.
Nov. 16	SUPPLEMENTAL response by pltf. to deft. and intervenor-defts. first set of interrogatories sealed per order of Judge Bryant on 11-16-76
Dec. 3	DEPOSITION of Dean K. Crowther for pltf. taken on 10-28-76; exhibits 1-27
Dec. 14	MOTION by pltf. for summary judgment; statement; P&A w/appendix A and B; further statement; further memorandum in opposition to intervenor-deft's motion for summary judgment
1977	
Jan. 31	SUPPLEMENTAL motion of the United States of America, deft.-intervenor, for summary judgment; opposition of deft.-intervenor to motion by pltf. for summary judgment; supplemental statement; statement of genuine issues; memorandum
Feb. 14	RESPONSIVE memorandum by pltf.; supplemental statement of genuine issues
Aug. 12	MEMORANDUM and order granting in part and denying in part motions of deft. and deft.-intervenor for summary judgment; granting in part and denying in part motion of pltf. for summary judgment; and dismissing case. (Signed 8-11-77) (N) Bryant, C.J.
Aug. 22	MOTION of pltf., Merck & Co., Inc. to alter or amend the judgment, memorandum of Points and Authorities
Sept. 15	OPPOSITION of deft. and intervenor-deft. to pltf. motion to alter or amend judgment; memorandum
Sept. 23	REPLY memorandum of pltf. in support of its motion to alter or amend judgment

DATE	
1978	
* * *	
1979	
Jan. 24	JUDGMENT AND ORDER denying in part and granting in part motion of pltf. to amend or alter judgment of 8-12-77; granting in part and denying in part motion of deft. and deft.-intervenor for summary judgment; granting in part and denying in part motion of pltf. for summary judgment; each party to bear own costs; and Court retains jurisdiction. (Signed 1-23-79) (N) Bryant, C.J.
Mar. 14	NOTICE of appeal of defts. from Order of January 24, 1979. Govt. no fee
Mar. 21	NOTICE of cross-appeal of pltf. from Judgment and Order filed 1-24-79

*

Supreme Court of the United States

No. 81-1273

CHARLES A. BOWSHER, COMPTROLLER GENERAL, *et al.*,
Petitioners,

v.

MERCK & CO., INC.

No. 81-1472

MERCK & CO., INC.
Petitioner,

v.

CHARLES A. BOWSHER, COMPTROLLER GENERAL, *et al.*

ORDER ALLOWING CERTIORARI. Filed April 19, 1982

The petitions for writs of certiorari are granted. The cases are consolidated and a total of one hour is allotted for oral argument.

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

MERCK & CO., INC.
126 East Lincoln Avenue
Rahway, New Jersey 07065,
Tel.: 201-381-5000
Plaintiff.

—against—

ELMER B. STAATS, Comptroller
General of the United States,
441 G Street, N.W.
Washington, D.C. 20548,
Defendant.

UNITED STATES OF AMERICA
Defendant-Intervenor.

AMENDED COMPLAINT

Plaintiff, by its attorneys, Hughes Hubbard & Reed, complaining of defendant, alleges:

THE PARTIES

1. Plaintiff Merck & Co., Inc. ("Merck") is a corporation duly organized and existing under the laws of the State of New Jersey, having its principal place of business in Rahway, New Jersey. Merck is engaged in, among other things, the manufacture, distribution and sale of pharmaceutical products.

2. Defendant Elmer B. Staats is the Comptroller General of the United States and resides and is found in such capacity in the District of Columbia.

JURISDICTION

3. This is an action for a declaratory judgment pursuant to 28 U.S.C. § 2201 for the purpose of determining an actual controversy between the parties, as hereinafter more fully appears.

4. (a) The matter in controversy exceeds the sum or value of $10,000, exclusive of interests and costs and the action arises under the laws of the United States, namely, 31 U.S.C. §§ 53 and 67, 10 U.S.C. § 2313(b), 41 U.S.C. § 254(c), and the Administrative Procedure Act, 5 U.S.C. § 501, *et seq.*

(b) This Court has jurisdiction of this action by virtue of 28 U.S.C. §§ 1331(a), 1332, 2201, § 10(a) of the Administrative Procedure Act, 5 U.S.C. § 702, and § 11-521 of the D.C. Code.

THE CONTROVERSY

5. On or about the dates set forth below, Merck entered into the following contracts (the "Contracts") for the sale by Merck of the pharmaceutical products (the "Products") described below to agencies or departments of the United States of America:

Date of Contract	Purchaser	Contract Number	Product Sold
November 19, 1973	Veterans Administration	V797P-5077c	Diuril
August 17, 1973	Department of Defense	DSA 120-74-C-0680	Influenza Virus Vaccine, Monovalent
December 18, 1973	Department of Defense	DSA 120-74-C-1813	Benemid
May 14, 1973	Department of Defense	DSA 120-73-D-2842	Aldomet

6. The Products sold by Merck pursuant to the Contracts are standard commercial items which are sold in substantial

quantities to the general public at established catalogue prices. The prices paid for the Products pursuant to the Contracts were not determined on a "cost plus" basis or any other method based on costs of production. Instead the prices paid pursuant to the Contracts were either determined (a) on the basis of such catalogue prices or (b) on the basis of adequate price competition, within the meaning of 10 U.S.C. § 2306, Armed Services Procurement Regulations § 3-807 and 41 CFR §§ 1-3.807 and 8-3.807. As a result, the prices paid pursuant to the contracts were in each instance either equal to or less than the established catalogue prices for such items.

7. Defendant, by letter dated August 26, 1974 (the "Letter") has formally requested that Merck, pursuant to 31 U.S.C. §§ 53 and 67, 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c):

> "make available to the General Accounting Office as required, all books, documents, papers, and other records directly pertinent to the contracts [the Contracts], which include, but are not limited to (1) records of experienced costs including costs of direct materials, direct labor, overhead, and other pertinent corporate costs, (2) support for prices charged to the Government, and (3) such other information as may be necessary for use to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government interests."

8. Defendant has no right under the statutes cited in the letter or under any other authority or under the Contracts to examine the books, documents, papers and other records specified in the Letter, and Defendant's demand for this information is arbitrary, without lawful basis and in excess of statutory authority.

9. Compliance by Merck with this unauthorized, illegal and overly broad request would not only be extremely burdensome and costly, but disclosure of the confidential information requested will result in irreparable competitive injury to Merck. Moreover, if Merck were to refuse to comply with Defendant's unlawful demand, its relationships with other

agencies of the United States of America could be seriously prejudiced, and formal and informal impediments could be created which would adversely affect Merck's ability to enter into future contracts for the sale of products to such agencies.

10. Merck has no prompt, adequate and effective remedy at law, and the present action is the only means available to Merck for the protection of its rights and for protection against the immediate, substantial and irreparable damage and injury which Merck faces as herein above alleged.

WHEREFORE, Plaintiff demands judgment against Defendant declaring that Defendant has no right or authority to examine the books, documents, papers and other records specified in the Letter and for such other, further and different relief as may seem just and proper.

Dated: Washington, D.C.
March 11, 1975

HUGHES HUBBARD & REED

By _____

1660 L Street, N.W.
Washington, D.C. 20036
(202) 872-8250

Attorneys for Plaintiff
Merck & Co., Inc.

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

Merck & Co., Inc.,

Plaintiff,

v.

ELMER B. STAATS, Comptroller General of the United States,

Defendant.

ANSWER AND COUNTERCLAIM OF DEFENDANT UNITED STATES OF AMERICA

ANSWER

1 - 2. Defendant admits the allegations of paragraphs 1 and 2 of the complaint.

2 - 3. The allegations contained in paragraphs 3 and 4 of the complaint are conclusions of law as to which no answer is required; however, if an answer is deemed to be required, the allegations are denied.

5. Defendant admits the allegations of paragraph 5 of the complaint except he denies that the drug names listed in paragraph 5 of the complaint as forming the subject matter of contract Nos. U797P-5077(c), DSA120-74-1813 and DSA 120-73-D-2842 are the same as those listed in the contracts themselves.

6. Defendant admits the allegations of the first sentence of paragraph 6 of the complaint. Defendant lacks knowledge or information sufficient to form a belief as to the truth of the allegations contained in the second sentence of paragraph 6 of the complaint.

7. Defendant admits the allegations of paragraph 7 of the complaint.

8-10. Defendant denies the allegations of paragraphs 8-10 of the complaint.

Defendant denies each and every allegation of the complaint not expressly admitted, qualified, or denied above.

FIRST DEFENSE

The complaint fails to state a claim upon which relief can be granted.

SECOND DEFENSE

The Court lacks jurisdiction over the subject matter of the complaint.

COUNTERCLAIM

1. The United States of America for its counterclaim herein alleges as follows.

2. This case arises under 10 U.S.C. 2312(b) Chapter 137, 41 U.S.C. 254(c), and four contracts entered into between the Veterans Administration and the Defense Supply Agency and Merck & Company, Incorporated (hereinafter referred to as Merck) pursuant to said Chapter 137 and 41 U.S.C. 254(c). Jurisdiction is conferred upon this Court by virtue of 28 U.S.C. 1345 and the request for relief is made pursuant to Title 28 U.S.C. §§ 2201 and 2202.

3. Plaintiff Merck is a corporation organized and existing under the laws of the State of New Jersey, with a principal place of business in Rahway, New Jersey.

4. On or about November 19, 1973, the Veterans Administration awarded a contract to plaintiff Merck which contract was designated as contract number U797P-5077(c), wherein

Merck agreed to furnish the plaintiff certain pharmaceutical products. This contract was negotiated pursuant to the provisions of 41 U.S.C. 252(c)(10) and final payment on such contract has not yet been made.

5. On or about August 17, 1973, the Defense Supply Agency of the United States awarded a contract to plaintiff Merck which contract was designated as contract number DSA 120-74-C-0680, wherein Merck agreed to furnish to the plaintiff certain pharmaceutical products. This contract was negotiated pursuant to the provisions of 10 U.S.C. 2304(a)(7) and final payment on such contract was made on November 7, 1973.

6. On or about December 18, 1973, the Defense Supply Agency of the United States awarded a contract to plaintiff Merck which contract was designated as contract number DSA 120-74-C1813, wherein Merck agreed to furnish to the plaintiff certain pharmaceutical products. This contract was negotiated pursuant to the provisions of 10 U.S.C. 2304(a)(7) and final payment on such contract was made on April 10, 1974.

7. On May 14, 1973, the Defense Supply Agency of the United States awarded a contract to plaintiff Merck which contract was designated as contract number DSA 120-73-D-2842, wherein Merck agreed to furnish to the plaintiff certain pharmaceutical supplies. This contract was negotiated pursuant to the provisions of 10 U.S.C. 2304(a)(7) and final payment of such contract has not yet been made.

8. Each of the aforementioned contracts exceeded the sum of $2,500. Pursuant to the provisions of 41 U.S.C. 254(c) the above-numbered contract mentioned in paragraph four of this counterclaim incorporates by reference Standard Form 32, General Provisions, Supply Contract, November, 1969, as modified by Veterans Administration Marketing Center Supplemental Provision No. 2, May 7, 1973, which includes a clause (identified as "clause 10—Examination of Records by Comptroller General) which provides as follows:

> (b) The contractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years

after final payment under this Contract, or such lesser time specified in either Appendix M of the Armed Service Procurement Regulations 1-20, as appropriate, have access to and the right to examine any directly pertinent books, documents, papers, and records of the Contractor involving transactions related to this contract.

(c) The contractor further agrees to include in all his subcontracts hereinunder a provision to the effect that the subcontractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of 3 years after final payment under the subcontract or such lesser time specified in either Appendix M or Armed Services Procurement Regulations Part 1-20, as appropriate have access to and the right to examine any directly pertinent books, documents, papers and records of such subcontractor involving transactions related to the subcontract. The term "subcontractor" as used in this clause excludes (I) purchase orders not exceeding $2,500 and (II) subcontracts in purchase orders for public utility services at rates established for uniform applicability to the general public.

9. Pursuant to the provisions of 10 U.S.C. 2313(b) each of the above-numbered contracts mentioned in paragraphs five, six, and seven (5, 6, and 7) of this counterclaim incorporates by reference Standard Form 32, General Provisions, Supply Contract, November, 1969 which includes a clause (identified as "Clause 10—Examination of Records") which provides as follows:

(a) The Contractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment under this contract, have access to and the right to examine any directly pertinent books, documents, papers, and records of the Contractor involving transactions related to this contract.

(b) The Contractor further agrees to include in all his subcontracts hereunder a provision to the effect that the

subcontractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment under the subcontract, have access to and the right to examine any directly pertinent books, documents, papers, and records of such subcontractor, involving transactions related to the subcontract. The term "subcontract" as used in this clause exludes (I) purchase order not exceeding $1,000 and (II) subcontracts or purchase orders for public utility services at rates established for uniform applicability to the general public.

10. The contracts mentioned in paragraphs four, five, six and seven (4, 5, 6, and 7) of this counterclaim were not entered into by means of formal advertising.

11. On August 26, 1974 Elmer B. Staats, Comptroller General of the United States, pursuant to the provisions of the said clause 10, requested from Henry W. Gasden, Chairman and Chief Executive Officer of Merck all books, documents, papers, and other records relating to experienced costs including costs of direct materials, labor, overhead, and other corporate costs, support for prices charged to the Government, and such other necessary information which would permit his duly authorized representatives to review the reasonableness of the contract prices provided for in the aforesaid contracts. This request was denied by James M. Fulton, Vice President, General Counsel, and Secretary of Merck & Co. for the stated reason that disclosure of the product cost data would result in competitive injury to Merck. The books, documents, papers and records relating to the pricing and experienced costs, including costs of direct materials, labor, overhead, and other corporate costs hereinbefore mentioned are in the custody and control of the plaintiff Merck including its officers and subordinates.

12. The refusal of the plaintiff to permit the Comptroller General of the United States or his authorized representative to have access to and to examine the cost data mentioned in paragraph eleven (11) of this counterclaim relating to the four above-mentioned contracts, constitutes a violation of the provi-

sions of clause 10 included in the contracts pursuant to 10 U.S.C. 2313(b) and 41 U.S.C. 254(c) and is in direct contravention of the provisions of clause 10 contained in the contracts. The refusal to make available for inspection, the aforesaid books and records of plaintiff Merck containing the cost data relating to these contracts has prevented and will continue to prevent the Comptroller General of the United States from discharging his duty and right to examine such books and records unless the plaintiff is enjoined by this Court.

Wherefore, defendant prays that this Court issue an Order:

1. Declaring that pursuant to the provisions contained in the contracts designated and referred to in paragraphs four, five, six and seven (4, 5, 6, and 7) of this counterclaim and the provisions of 10 U.S.C. 2313(b) and 41 U.S.C. 254(c), the Comptroller General of the United States and his duly authorized representatives have the right to examine all books, documents, papers, or records directly relating to the pricing and cost of producing the items furnished by plaintiff Merck under the aforesaid contracts, including but not limited to records of experienced costs including costs of direct materials, labor, overhead, and other corporate costs, records in support for prices charged to the plaintiff and all other data and records of Merck concerning activities and operations of said company which were involved in any way with the incurrence of costs in furnishing the items produced pursuant to said contracts.

2. Enjoining plaintiff Merck, its officers, agents, servants, attorneys, employees and all persons in active concert or participation with them who receive actual notice of an order by personal service or otherwise, from preventing the duly authorized representatives of the Comptroller General of the United States from obtaining access to and examining any books, documents, papers, or records of the plaintiff that relate to and involve transactions relating to the pricing and cost of producing the items which were furnished by plaintiff Merck pursuant to the four abovementioned contracts; and directing plaintiff Merck including its officers and subordinates at a time and date fixed by the Court to have available on the premises of Merck & Co., Inc., Rahway, New Jersey, and its other principal

offices wherever located, such books and records which the Court adjudges in this action the Comptroller General and his duly authorized representatives have the right to examine.

3. Enjoining plaintiff Merck acting by and through its officers and subordinates from preventing the duly authorized representatives of the Comptroller General of the United States from obtaining access to and examining any books, documents, papers, or records of plaintiff Merck that relate to and involve transactions relating to pricing and experienced costs including costs of direct materials, labor, overhead and other corporate costs, support for prices charged to the government and such other necessary information which would permit his representatives to review the reasonableness of the contract prices provided for in the aforesaid contracts.

4. Granting such other and further relief as may be just and equitable.

Respectfully submitted,

CARLA A. HILLS

Carla A. Hills
Assistant Attorney General

EARL J. SILBERT

Earl J. Silbert
United States Attorney

HARLAND F. LEATHERS

Harland F. Leathers

DAVID EPSTEIN

David Epstein

Attorneys, Department of Justice
Attorneys for Defendant

[Comptroller General's Access-To-Records Demand Letter]

COMPTROLLER GENERAL OF THE UNITED STATES
Washington, D.C. 20548

B-146857 August 26, 1974

MR. HENRY W. GASDEN
Chairman and Chief Executive Officer
Merck and Company, Inc.
126 East Lincoln Avenue
Rahway, New Jersey 07065

Dear Mr. Gasden:

As you know, because of the increasing Federal involvement in the procurement of pharmaceuticals, the General Accounting Office has underway a review of the procurement of drugs by agencies of the Federal Government, including the pricing of drugs and pharmaceuticals procured under negotiated contracts. This examination is being conducted at several drug companies, including Merck and Company, Inc., and is being made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), the Accounting and Auditing Act of 1950 (31 U.S.C. 67), and the authority of the Comptroller General to examine contractors' records under the contract provisions pursuant to 10 U.S.C. 2313(b) and 41 U.S.C. 254(c).

For some time we have been attempting to gain access to records we consider necessary to conduct such a review. In this regard, in June 1973 we met with representatives of the Pharmaceutical Manufacturers Association and six drug firms to initiate a comprehensive review using data provided on a voluntary basis by representative industry firms. However, the industry firms have not provided us access to the records necessary to satisfactorily carry out our statutory responsibilities.

On a number of occasions since this effort was initiated, representatives of the drug industry have questioned our right

of access to necessary records on the grounds that (1) our request for cost data was considered inappropriate because the contracts were negotiated on the basis of standard catalog prices without regard to cost or profit margins; (2) the records apply basically to non-Government work; and (3) disclosure of cost data would be of benefit to competitors and damage the company if publicly disclosed. Our Office's right of access to such records was clearly decided by the courts in *Hewlett-Packard Company* v. *United States,* 385 F.2d 1013 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968). The Hewlett-Packard case involved all of the issues the industry has raised.

The purpose of this letter is to formally request that cost records pertinent to contracts listed in enclosure 1 be made available for our examination as provided by the terms of the negotiated contracts awarded to your company by the Defense Supply Agency and the Veterans Administration. We must request that you have the responsible officials at Merck and Company, Inc., make available to the General Accounting Office as required, all books, documents, papers, and other records directly pertinent to the contracts, which include, but are not limited to (1) records of experienced costs including costs of direct materials, direct labor, overhead, and other pertinent corporate costs, (2) support for prices charged to the Government, and (3) such other information as may be necessary for use to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government's interests. For your information, statements from the legislative history pertaining to the "Examination of Records" clause included in the contracts and our position on the duties and responsibilities that the clause imposes upon my Office are presented in enclosure 2.

We request also that you advise us within 15 days with respect to your decision to make these records available for our examination.

Sincerely yours,

/s/ ELMER B. STAATS

Comptroller General of the United States

Enclosures—2

LISTING OF CONTRACTS AND, WHERE APPROPRIATE, PURCHASE (DELIVERY) ORDERS TRANSACTED BETWEEN THE U.S. GOVERNMENT AND MERCK AND COMPANY

Contract Number	Date
Veterans Administration:	
V797P-5077c	Nov. 19, 1973
Purchase Orders:	
74-MC-50479	March 14, 1974
Department of Defense:	
DSA120-74-C-0680	Aug. 17, 1973
DSA120-74-C-1813	Dec. 18, 1973
DSA120-73-D-2842	May 14, 1973
Delivery Orders:	
0001	July 27, 1973
0002	Oct. 3, 1973
0003	Feb. 4, 1974
0004	Mar. 29, 1974

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

MERCK & CO., INC.,
Plaintiff,

v.

ELMER B. STAATS, Comptroller General of the United States,
Defendant.

AFFIDAVIT OF PAUL G. DEMBLING IN SUPPORT OF MOTION OF THE UNITED STATES FOR SUMMARY JUDGMENT

CITY OF WASHINGTON
DISTRICT OF COLUMBIA

Paul G. Dembling, being first duly sworn, deposes and says:

1. I am, and have been since November 17, 1969, General Counsel of the General Accounting Office. In that position I act as chief legal advisor to the Comptroller General of the United States, who is the head of the General Accounting Office. Under section 312 of the Budget and Accounting Act, 1921, 42 Stat. 25, the Comptroller General is responsible for investigating all matters relating to the disbursement and application of public funds, for submitting to the Congress reports on the adequacy and effectiveness of the administrative examination of accounts and recommendations looking to greater economy or efficiency in public expenditures, and for reporting any expenditure or contract made in violation of law. As part of my duties I am charged with reviewing generally, and

particularly for legal sufficiency, the report and recommendations prepared for submission to Congress under the cited statutory authority.

2. There is included in negotiated contracts pursuant to 10 U.S.C. 2313(b) and 41 U.S.C. 254(c) a clause which provides in substance that the Comptroller General or any of his duly authorized representatives shall, until the expiration of three years after final payment, have access to and the right to examine any directly pertinent books, documents, papers and records of the contractor or his subcontractors involving transactions related to the contract or subcontracts (access-to-records clause). The access-to-records clause and the statute requiring its inclusion in negotiated contracts has been consistently used by the Comptroller General since enactment of the statute; and I know of no official congressional action to modify the statute or the access-to-records clause to limit their interpretation as asserted by the Comptroller General.

3. Examinations and audits of contractor records pursuant to the access-to-records clause have, as hereinafter detailed, resulted in (1) effecting a reduction in price in instances where such prices were regarded by representatives of the Comptroller General as excessive, (2) obtaining cost and price information which was given to procuring agencies for use in future negotiations and procurements, (3) providing a source for making recommendations to the Congress for Federal procurement legislation.

4. Examination by the General Accounting Office of contractors' records pertaining to negotiated contracts has resulted, in many instances, in the disclosure of profits considered by trained auditors in the employ of the General Accounting Office to be abnormally high. In a number of cases it has been possible, through the use of the contractual right to examine such records, to effect a reduction in such prices. For example, I have reviewed records of the General Accounting Office which show that the total value of contracts and subcontracts exam-

ined pursuant to the access-to-records clause by our Procurement and Systems Acquisition Division in fiscal years 1974 and 1975 to date was $814,900,000. Of that amount, those records show that $4,064,437 was determined to be the result of overpricing. I have also reviewed records of the General Accounting Office which show that in fiscal years 1974 and 1975 to date, $5,004,135 was recovered from contractors and subcontractors as a result of earlier determinations of overpricing made pursuant to access-to-records clause investigations by the General Accounting Office. The General Accounting Office could not have performed the type of audits which led to the initiation of action to effect the recoveries, without the access to the contractors' records made possible by the inclusion in the contracts of the access-to-records clause.

In addition to leading to the described recoveries, the disclosure of profits deemed abnormally high has resulted in instances where the Comptroller General has advised the contracting agencies to negotiate prices more carefully or to obtain greater competition in future similar procurements.

Also, findings resulting from audits which included the examination of production cost records under contracts negotiated with the Government have provided a source for recommendations to the Congress for amending Federal Procurement legislation.

/s/ PAUL G. DEMBLING

Paul G. Dembling

Subscribed and sworn to before me
this 2nd day of April, 1975.

My Commission expires:

/s/ CARL C. BEIGER

Notary Public

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

MERCK & CO., INC.,
Plaintiff,

v.

ELMER B. STAATS, Comptroller General
of the United States,
Defendants,

and

THE UNITED STATES OF AMERICA,
Intervenor-Defendant.

AFFIDAVIT OF T. J. DRYGAS IN OPPOSITION TO THE MOTION OF THE UNITED STATES FOR SUMMARY JUDGMENT

STATE OF PENNSYLVANIA
COUNTY OF MONTGOMERY

T. J. DRYGAS, being duly sworn, deposes and says:

1. I am the Manager of the Sales Services department of Merck Sharp & Dohme, a division of Merck & Co., Inc., responsible for processing all purchase orders, solicitations and proposals received from governmental and public customers. I have held this position since 1961. I am personally familiar with facts and circumstances respecting the solicitation, negotiation and award of contract numbers V797P-5077C, DSA 120-74-C-0680, DSA 120-74-C-1813 and DSA 120-73-D-2842 which form the subject of the present suit.

* * *

[page 17 of affidavit]

31. It was the understanding of Merck that the Comptroller General's right of access to records and that of the Department of Defense were substantially identical and that generally neither was applicable to contracts based on adequate price competition or on established catalog or market prices except to verify that the claimed price competition or catalog or market prices were the actual selling prices at which the products were sold to general public. It was Merck's understanding that the Comptroller General, like the Department of Defense, does not have a right under the contract clause to obtain cost information where the contract price is based upon adequate price competition or established catalog or market prices and no information or representations about costs were submitted prior to the award of the contract. Although with respect to these four contracts no information pertaining to Merck's costs in developing, manufacturing and marketing the products procured was ever requested by any of the contracting officers, whenever such confidential cost information was requested in connection with any other firm fixed price contract based on adequate price competition or established catalog or market prices Merck has always refused to disclose such information since it was not pertinent to either the price submitted nor relevant to the contract's performance, and the Government acquiesced to Merck's objections. Merck was not advised or otherwise placed on notice that the Comptroller General viewed his contract right more broadly than that of the Department of Defense in this material aspect. Nor was Merck advised or otherwise placed on notice that the Comptroller General would assert this contract provision in an effort to gain access to all of Merck's books, records, papers and documents for the purpose of conducting an economic survey of the pharmaceutical industry.

32. The prices at which Merck offered to sell the products purchased by the V.A. and the D.S.A. pursuant to the above discussed contracts were established prior to receipt of the solicitations and set principally on the basis of market considerations. The principal market factors were the prices at which

competing products were being sold generally, and the competing bids submitted pursuant to prior solicitations. In each instance the contracting officer accepted Merck's offer without actually attempting to negotiate a lower price.

33. To my knowledge neither the V.A. nor the D.S.A. has ever suggested that the contract price was not fair and reasonable or that the pricing information submitted was false or inaccurate or that the contracting officer was otherwise misled with respect to price during the negotiations. On the contrary, in each instance, the price of the contract was not only substantially below the market price because of the volume of the purchase but also the lowest price per unit at which each of the pharmaceutical products had been sold to anyone at the time.

34. Merck never understood or intended the words "directly pertinent" in the Comptroller General's access-to-records provision to have included any cost information.

/s/T. J. DRYGAS

T. J. Drygas

Subscribed and sworn to before
me this 2nd of June, 1975

/s/MARJORIE E. SHAY

Notary Public

My Commission Expires:

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

MERCK & CO., INC.,
Plaintiff,

v.

ELMER B. STAATS, Comptroller General
of the United States,
Defendant,

and

THE UNITED STATES OF AMERICA,
Intervenor-Defendant.

AFFIDAVIT OF PHILIP H. ROY IN OPPOSITION TO THE MOTION OF THE UNITED STATES FOR SUMMARY JUDGMENT

STATE OF NEW JERSEY
COUNTY OF UNION

PHILIP H. ROY, being duly sworn, deposes and says:

1. I am Vice President-Finance of Merck & Co., Inc. ("Merck"). I am personally familiar with financial matters pertaining to the pharmaceutical products sold by Merck through its Merck, Sharp & Dohme division ("MSD"), including the pharmaceutical products purchased by the Government. I am also familiar with a General Accounting Office ("GAO") 1973-74 study of the pharmaceutical industry conducted through and with the cooperation of the Pharmaceutical Manufacturers Association ("PMA") and six of its member companies, including Merck.

2. Merck is a corporation organized and existing under the laws of the State of New Jersey, has its principal place of

business in Rahway, New Jersey, and is engaged principally in the research, development, manufacture and sale of pharmaceutical products prescribed by doctors ("ethical pharmaceuticals"). MSD is the division through which Merck markets ethical pharmaceuticals in the United States.

3. Defendants have demanded that Merck make available for examination all of its cost records relating to the contracts in dispute for the purpose of ascertaining Merck's costs and profits and comparing the information obtained to that acquired from other pharmaceutical companies. In opposition to this demand, this affidavit is submitted to establish

(a) that the demand is being made for a purpose not within the intent of the access-to-records provision;

(b) that the Defendants may not compel production of Merck's cost records because the prices under the disputed contracts are not based on costs;

(c) that allocation of costs for specific products, in the absence of established accounting principals for such purpose, cannot be accomplished in a statistically fair and reliable manner;

(d) that even the attempt to satisfy Defendants' demand would require examining all of Merck's records relating to costs and expenses, including enormous masses of raw data;

(e) that because of differences between pharmaceutical companies the information acquired from one cannot usefully be compared to that of another company;

(f) that disclosure of confidential cost information to competitors or bid customers will result in serious competitive injury to Merck; and

(g) that Merck has always considered cost information not directly pertinent to any firm-fixed price contract if representations as to costs were not a factor in the negotiation of the price.

4. In late 1972, PMA and a number of its member firms were approached by GAO with respect to a proposed study of

the pharmaceutical industry designed to evaluate production processes, management, efficiency and cost and profits for both specific products and for the industry as a whole. The proposed study was found unacceptable because of substantial problems of its feasibility and the lack of assurance that the confidentiality of the information obtained would be preserved. These objections presented in a letter dated December 13, 1972 from PMA (appended hereto as Exhibit A), were explained as follows:

> "You will recall that at the outset, both PMA and GAO representatives recognized the conceptual difficulties surrounding any attempt to develop product cost and investment data. The cost allocation problems are compounded by the unique characteristics of the pharmaceutical industry. The commonality of all productive elements as well as the broad range of products, dosage forms and strengths, and package sizes produced, make it extremely difficult, if not impossible, to allocate indirect and even some direct costs in a clear and meaningful way. Complicating factors include:
>
> > . . . non-successful research represents a large cost which cannot be identified with specific marketed products.
> >
> > . . . "period" or "programmed", as distinguished from direct, product costs are a vital component of the availability of pharmaceutical products. Usually, these can only be allocated to specific product groups on arbitrary bases, and the bases will vary depending upon the purpose. The time lag aspects are particularly difficult to resolve.
> >
> > . . . substantial research and development costs are sustained for a good many years prior to introduction and successful marketing of a new product. These are usually expensed as incurred. Identification of which of these costs

> relate to particular products, and a determination of an appropriate basis to allocate these costs to any particular time period is also difficult to resolve and will vary depending upon the purpose.
>
> . . . education of physicians and other medical professionals, promotion and other distribution expenses are incurred in periods prior to the time when ultimate sales realizations occur; educational efforts are generally much higher during the product introduction phase with any earnings occurring after the product has achieved market acceptance by physicians. To segregate these expenses by product during a specific fiscal period will give a distorted concept of profit contribution.
>
> "In addition to the allocation problems noted, the industry is concerned that confidential business information not become public. Unfortunately, the GAO cannot provide any assurance that this will not occur. ***"

5. By June 1973, the GAO had modified its objectives and proposed a revised study to be conducted in two phases. (The GAO proposal is appended hereto as Exhibit B.) In Phase I the GAO intended to learn the general nature, peculiarities and problems of the industry, focussing specifically on manufacturing processes, accounting systems, and marketing policies, and to select the areas to be studied in depth in Phase II and assess what realistically could and could not be accomplished in the second step of the study. Phase I was to be accomplished by visits to the facilities of the cooperating pharmaceutical companies. Merck and five other pharmaceutical companies volunteered to participate in Phase I on the understanding that access to detailed cost records pertaining to specific products would not be granted.

During November 1973, GAO visited and inspected Merck's facilities and operations at Rahway, New Jersey, and

West Point, Pennsylvania, and consulted at length with representatives of Merck. GAO made similar visits to five other cooperating pharmaceutical companies.

6. On March 21, 1974, GAO met with representatives of the six cooperating companies to present and discuss its preliminary Phase I findings. On or about April 17, 1974, GAO issued the Phase I report in written form and a proposal for Phase II. The Phase I report, however, differed in many material aspects from the prior oral presentation. Detailed and specific comments on the report were submitted by PMA on behalf of the six cooperating companies (appended hereto as Exhibit C) and separate comments were also submitted by the individual cooperating companies.

By letter dated June 6, 1974 (appended hereto as Exhibit D), Merck submitted its additional comments on the Phase I report:

> "1. The Phase I Observations seem to us to represent a limited view in that they omit or give insufficient emphasis to the economic and social benefits of the industry's new product developments, the multi-national character of the industry, R&D intensity relative to other industries and industry distribution, which gives a high probability of product availability when and where needed.
>
> "2. It was our impression that you had concluded that it is not possible for a pharmaceutical company to determine product profitability in a meaningful way. If this impression is correct, we believe that such a statement should be recorded in the Phase I Observations.
>
> "3. Discussion of the industry's cost structure should record the fact that costs directly associated with products are small in relationship to the total costs and expenses of a pharmaceutical company. This is an important fact in any study of cost/price relationships. It also helps to understand the potential for error in attempts to allocate non-product costs to products.

> "4. The Phase I Observations place great emphasis on matters bearing on price competition. In our view, competition includes competition in innovation through research, in quality of product, and in range and kind of services as well as price competition."

Concerned about the feasibility of Phase II, Merck requested the GAO to submit to it the accounting rules whereby it intended to allocate costs. Merck also expressed its concern over the lack of any assurance of confidentiality.

> "Concerning Phase II, I have some serious reservations. We are willing to work with you on those aspects of your proposal which do not deal with profitability or other significant confidential material. However, as we have already said, product profitability necessitates cost and expense allocations for which there are no generally accepted accounting principles. We believe that if you desire us to develop information of this type, you should set rules for such allocations—i.e., you should tell us and all other participants how to make them. Regarding the other confidential material, we have been concerned since our initial meeting with your acknowledged inability to assure us that you could maintain such information on a confidential basis. We recognize your problem and we appreciate the efforts you are making to get us this assurance. However, until we can develop a method which will assure us full protection, there may be some parts of your review to which we will be unable to respond."

7. Despite Merck's willingness to cooperate further upon satisfactory resolution of the above problems, the Comptroller General, in lieu of pursuing the original Phase II study, decided to obtain access to Merck's cost records and those of the other companies that cooperated in Phase I by asserting his alleged rights under the access-to-records provision of various contracts thereby precipitating this and other litigation. Formal demand was made by letter dated August 26, 1974 (appended hereto as

Exhibit E), that certain confidential cost information be made available for examination. Merck by letter dated September 17, 1974 (appended hereto as Exhibit F), requested an extension of time until October 1 to respond to the Comptroller General's demands. The extension was granted and, contrary to the Defendants' representations, Merck by letter dated September 30, 1974 (appended hereto as Exhibit G), submitted its response to the Comptroller General advising him that it had decided to seek judicial resolution of the meaning of the access-to-records clause upon which his demands were based.

8. Defendants Statement of Facts (¶ 13 at p. 7) contains the remarkable admission that:

> "In June, 1974 GAO dropped its plans for a Phase II investigation since it became clear that the industry was unwilling to voluntarily permit access to the data necessary for the performance of the detailed study contemplated. In its place GAO is conducting a study [the present study] based on data obtained through the use of GAO access-to-records authority under specified negotiated contracts. (Ahart Aff., Exhibit B. p. 4)."

Thus, it is clear that the Comptroller General is attempting to use the access-to-records provision of these contracts not to audit the particular contracts to ascertain if there was any impropriety in their negotiation but to carry out Phase II of the GAO's general investigation of the pharmaceutical industry.

9. Merck has offered to give to the Comptroller General all the necessary data concerning the prices at which Merck sold these products generally so that he could verify that the products were in fact sold to the public in substantial quantities at the represented catalog prices. This is all the information that is directly pertinent to auditing these particular contracts because neither the negotiation of the contracts nor their performance were contingent on or related to Merck's costs.

10. In fact, the catalog prices of Merck's pharmaceutical products are not generally based upon considerations of cost

but rather on the basis of market factors such as the prices of competing products.

11. The reasons why Merck's catalog prices are not determined by considerations respecting cost are myriad and peculiar to the nature of Merck's business of developing and producing ethical drugs. The principal reason, however, is that there is no generally accepted set of accounting principles for allocating all costs to any product or any particular package of that product.

12. Merck's cost accounting system for pharmaceutical products is part of a system of establishing inventory product standards based on periodic projections of direct costs and certain variable overhead items. This system is part of an overall budgetary system which charges management with results against plan, including inventory standards, for those items which are controllable and for which they are directly responsible. Such product inventory standard costs contain only three cost elements, *i.e.*, direct materials, direct labor and certain overhead items of the production unit. Such indirect manufacturing costs as depreciation, taxes on the manufacturing facilities, building repairs, plant administrative expenses, deletions and discards, inventory adjustments, materials management, and general staff services are not included in the product inventory standards. Since Merck's cost system does not include the aforementioned indirect manufacturing costs, product costs do not reflect total manufacturing cost.

13. Beyond the level of direct manufacturing costs, Merck does not have available and believes it to be impossible to develop meaningful information for any one product with respect to such major cost components as administration, distribution, selling, legal, tax, general corporate and research and development costs which are not recorded on a product basis. Absent generally accepted accounting methods for the allocation of these indirect costs and expenses, any allocation of them would require wholly arbitrary decisions on the part of the analyst making the allocations. As such, any allocation would raise fundamental questions. For example, allocation of research and development expense would require an assump-

tion as to whether or not to count Merck's past research and development costs and, if so, how far back; whether to allocate costs of thousands of unsuccessful products as part of the cost of developing successful ones; and how to allocate costs to therapeutic classes, or even to human versus animal products. In the most recent fiscal year, for example, Merck's research and development expenses were $103,456,000 (Merck & Co., Inc., 1974 Annual Report at 1, appended hereto as Exhibit H), and involved hundreds of research projects, most of which will not evolve into specific products for future sale. The problem is further compounded by the fact that much of the data necessary to make the above allocations does not exist at all, or if extant does not exist in usuable form and would require new and onerous compilations to be made. Indeed indirect costs and expenses constitute a larger portion of the total cost and expenses than do direct costs.

14. Furthermore, in order to compile and compute these indirect costs and expenses, every voucher and expense invoice in Merck's files and all of Merck's records pertaining to costs will have to be examined. Then it will be necessary to change the existing accounting classification system to recode the basis of allocation of indirect costs and expenses from general to specific product categories.

15. It is also for the above reasons that neither the Comptroller General nor the GAO can accomplish in a statistically fair and reliable manner, without creating distortions and reaching arbitrary conclusions, the stated objective of the proposed investigation. Not only must new records be created, but also a cost accounting system must be developed which is compatible with every phase of Merck's operations as well as the operations of all other pharmaceutical companies. Even assuming the possibility of devising such a system, in attempting to allocate costs and correlate incompatible information, wholly arbitrary determinations will have to be made and serious distortions will result.

16. Information obtained from one pharmaceutical company cannot be validly compared to that of other companies. Pharmaceutical companies manufacture different types of prod-

ucts; quantities produced differ; manufacturing processes differ; labor costs differ from one area of the country to another; research expenditures and corporate objectives differ; management structures differ; patent rights and secret processes differ; rights to and sources of ingredients for combination differ; and sales and distribution methods differ. These differences would render the information obtained from one company largely irrelevant for purposes of comparing to that of another.

17. The cost information sought contains confidential information of the highest degree of confidentiality and the danger of disclosure of this information to anyone is of great concern to Merck. For example, this information would never be made available in the ordinary course of business to competitors or to bid customers. A competitor with knowledge of Merck's product costs and profit margins might effect price changes in its competing product lines or in competitive bidding with the result that neither Merck nor the competitor could maintain the reasonable profit which is essential to the health of the industry. Information regarding Merck's investment in research, advertising or sales would be of strategic advantage to any competitor in marketing. Likewise, were bid customers to have knowledge of Merck's product costs and profit margins, Merck would be placed at a serious bargaining disadvantage in negotiating the price of its contracts, and market competition would be replaced by the arbitrary judgments and dictates of such bid customers.

18. Furthermore, it is my understanding that although the Comptroller General and GAO have represented that they do not presently intend to disclose publicly the specific information obtained from their examination but rather merely to issue a general report (Ahart Aff. ¶¶ 14-15), nevertheless they have admitted that they cannot guarantee confidentiality. In light of the absence of an assurance that confidential cost information would not be disclosed to anyone outside GAO, the potential injury to Merck that would result from public disclosure outweighs the nebulous and questionable benefits sought by the Comptroller General in the proposed examination. It is for this reason also that Merck was reluctant to cooperate further with

the GAO Phase II program and why it is now challenging the lawfulness and reasonableness of the Comptroller General's attempt to use his limited audit rights under Government contracts to pursue this study.

19. Finally, with respect to any Government firm fixed-price contract, whether entered into pursuant to formal advertisement or negotiation, Merck has always taken the position that cost data are not directly pertinent to such contracts if the negotiation of the agreed upon price was not dependent upon representations of costs. It has always been Merck's understanding that under such circumstances the only legitimate interest that the Comptroller General has is to determine that the Government obtained the procured pharmaceuticals at the agreed price and that Merck's representations about its prices or sales, including its catalog-price sales, were accurate.

/s/ PHILIP H. ROY

PHILIP H. ROY

SUBSCRIBED AND SWORN TO BEFORE ME
THIS DAY OF JUNE 1975.

NOTARY PUBLIC

[Exhibit D to Roy Affidavit]

MERCK & CO., INC.
Rahway, N.J. 07065

June 6, 1974

Mr. Gregory J. Ahart
Director
Manpower and Welfare Division
United States General Accounting Office
Washington, D.C. 20548

Dear Greg:

By now you have received the letter from PMA discussing those sections of your April draft which dealt with Phase I. In addition to those comments I would like to add the following:

* * *

Concerning Phase II, I have some serious reservations. We are willing to work with you on those aspects of your proposal which do not deal with profitability or other significant confidential material. However, as we have already said, product profitability necessitates cost and expense allocations for which there are no generally accepted accounting principles. We believe that if you desire us to develop information of this type, you should set rules for such allocations—i.e., you should tell us and all other participants how to make them. Regarding the other confidential material, we have been concerned since our initial meeting with your acknowledged inability to assure us that you could maintain such information on a confidential basis. We recognize your problem and we appreciate the efforts you are making to get us this assurance. However, until we can develop a method which will assure us full protection, there may be some parts of your review to which we will be unable to respond.

We remain willing to discuss these considerations further, with the hope that meaningful program can be developed.

Sincerely,

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

MERCK & CO., INC.,
Plaintiff,

v.

ELMER B. STAATS, Comptroller General
of the United States,
Defendant,

and

THE UNITED STATES OF AMERICA,
Intervenor-Defendant.

DEFENDANTS' RESPONSE TO PLAINTIFF'S SECOND SET OF INTERROGATORIES

The defendants, by Gregory J. Ahart, Director of the Human Resources Division of the General Accounting Office (GAO) make the following answers to interrogatories propounded by plaintiff:

* * *

[page 3 of interrogatories]

Plaintiff's Interrogatory No. 2:

(a) With respect to each of the subject contracts, does the defendant or intervenor-defendant contend that Merck was required to submit cost and pricing data to the Government agency awarding the contract prior to the award of the contract?

(b) If the answer to Interrogatory 2(a) is affirmative as to any contract, state as to each such contract

(1) your understanding of the reasons why submission of such data was required, and

(2) whether such data was actually submitted and, if not, why the contract was awarded without such submission.

(c) If the answer to Interrogatory 2(a) is negative as to any contract, state as to each such contract your understanding of the reasons why submission of such data was not required.

Answer to Interrogatory No. 2:

(a) With respect to each of the subject contracts between plaintiff and DSA or between plaintiff and VA neither the defendant nor the intervenor-defendant contends that plaintiff was required to submit cost or pricing data to the Government.

(b) Plaintiff was not required to submit cost or pricing data in connection with DSA Contract No. DSA120-74-C-0680 since the agency determined that the contract price was based on adequate price competition. Plaintiff was not required to submit cost or pricing data in connection with the remaining contracts between DSA and plaintiff because the agency determined that the contract prices were based on established catalog or market prices of commercial items sold in substantial quantities to the general public.

Plaintiff was not required to furnish cost or pricing data in connection with its VA contract because the agency determined in accordance with Federal Procurement Regulations Section 1-3.807-3(g) that the administrative cost would outweigh the benefits which might otherwise accrue from the receipt of certified cost or pricing data.

Plaintiff's Interrogatory No. 3:

(a) Did any employee of the Government who participated in the decision to award the subject contracts to Merck either

(1) consider the proposed contract price unreasonable, or

(2) take any steps to bargain for a lower price, or

(3) request any explanation or support for the reasonableness of the price offered?

(b) If the answer to any portion of Interrogatory 3(a) is in the affirmative, identify the employee, contract, and explain the basis for his conclusion and/or describe the steps he took.

Answer to Interrogatory No. 3:

No Government employee who participated in the decision to award contracts DSA120-74-C-0680, DSA120-74-D-1813 or V797P-5077C considered the proposed price unreasonable or took any steps to bargain for a lower price or request any explanation or support for the reasonableness of the price offered.

In connection with Contract No. DSA120-73-C-2842, Mr. S. Gutstadt, Assistant Division Chief, at the request of Mr. W. E. O'Brien, Chief, Contract Review, requested plaintiff to provide information regarding plaintiff's pricing policy on this contract and information as to what constitutes an average commercial production run of the contract item.

Plaintiff's Interrogatory No. 4:

(a) Was the price which the Government agreed to pay under any of the subject contracts different from the price offered by Merck?

(b) If your answer to Interrogatory 4(a) is in the affirmative, identify the contract and the price differential and describe the circumstances leading to the difference.

Answer to Interrogatory No. 4:

The price which the Government agreed to pay under each of the subject contracts was no different from the price offered by plaintiff.

Plaintiff's Interrogatory No. 5:

(a) Is it the understanding of the defendant and the intervenor-defendant that the subject contracts are exempt from

renegotiation under the Renegotiation Act of 1951, as amended, 50 U.S.C. App. §§ 1211 et seq.?

(b) If your answer to Interrogatory 5(a) is affirmative as to any contract, identify the contract and state the reasons for your understanding that the contract is exempt from renegotiation.

(c) If the answer to Interrogatory 5(a) is negative as to any contract, identify the contract and state the reasons for your understanding that the contract is not exempt from renegotiation.

Answer to Interrogatory No. 5:

The authority to determine whether contracts are subject to the Renegotiation Act of 1951 is the responsibility of the Renegotiation Board. However, it is the understanding of GAO that the DSA contracts hereinvolved are exempt from the Renegotiation Act of 1951 under 50 U.S.C. App. 1216(e)(1)(A) as contracts for items which are standard commercial articles. It is the understanding of GAO that the VA contract hereinvolved is not subject to the terms of the Renegotiation Act of 1951, as that Act is not applicable to contracts let by the VA.

Plaintiff's Interrogatory No. 6:

(a) With respect to each of the subject contracts, do the defendant and the intervenor-defendant contend

(1) that the Government was induced to enter into the contract or to agree to any term of the contract as the result of any failure by Merck to disclose any information it was required to disclose prior to the award of the contract, or

(2) that any employee of Merck or of the Government involved in the award of the contract engaged in any illegal or unethical conduct in connection herewith, or

(3) that Merck failed to perform its responsibilities in accordance with the terms of the contract?

(b) If the answer to any portion of Interrogatory 6(a) is in the affirmative, identify the contract or contracts and the

persons involved, and describe the circumstances believed to constitute such failure or impropriety.

Answer to Interrogatory No. 6:

(a) The defendant and intervenor-defendant do not contend:

(1) that the Government was induced to enter into any of the subject contracts or to any term thereof as the result of any failure by plaintiff to disclose any information it was required to disclose prior to the award of the contract, or

(2) that any employee of plaintiff or of the Government involved in the award of these contracts engaged in any illegal or unethical conduct in connection therewith, or

(3) that plaintiff failed to perform its responsibilities in accordance with the terms of the contracts.

Plaintiff's Interrogatory No. 7:

(a) Do the defendant and the intervenor-defendant admit

(1) that the price set in each of the subject contracts was based on Merck's catalog price for the product or other indicia of adequate price competition, and

(2) that the price to the Government was lower than the price at which the product was sold to the public in substantial quantities as a standard commercial item?

(b) If your answer to any portion of Interrogatory 7(a) is in the negative, identify the contract and explain the basis for your denial.

Answer to Interrogatory No. 7:

(a) Defendant and intervenor-defendant admit that the price set in each of the subject contracts was based on plaintiff's catalog price for the product except that in the case of DSA Contract No. DSA120-74-C-0680 the contract price was determined by the agency to be based on adequate price competition.

The defendant and intervenor-defendant admit that the price to the Government under the subject contracts, except for DSA Contract No. DSA120-74-C-0680, was lower than the catalog price at which the product was sold to the public in substantial quantities as a standard commercial item. Since the agency determined that the "catalog price exception" to the requirement for the submission of cost or pricing data was not applicable to Contract No. DSA120-74-C-0680 because it determined that adequate price competition existed, the agency made no analysis of the relationship between the contract price and the price at which plaintiff sold the same item to the public.

Plaintiff's Interrogatory No. 8:

(a) Is the sole purpose of the defendant's request for access to Merck's books and records, as stated in the letter dated August 26, 1974 from the Comptroller General to Merck's chairman, to verify the representations made by Merck in obtaining the subject contracts and to audit Merck's performance of the contracts?

(b) If the answer to Interrogatory 8(a) is in the negative describe every purpose for which the defendant is requesting such access.

Answer to Interrogatory No. 8:

The sole purpose of the request for access to plaintiff's books and records is not to verify the representations made by plaintiff in obtaining the subject contracts and to audit plaintiff's performance of the contracts. Rather, the purpose of the request for access, as presently contemplated, is to review contract pricing by the Government's suppliers, including plaintiff, of drug items to determine the adequacy of the protection afforded the Government by the negotiation techniques used by the procuring agencies. Accomplishment of this objective is contingent upon GAO's ability to gain access to the records needed to (1) ascertain the nature of the activities for which the drug firms are incurring costs, (2) to ascertain and verify the extent to which the costs of these activities affect the prices paid by the Government for items procured under the specified

negotiated contracts, and (3) to determine the bases of firms' pricing considerations for the products and, particularly, the applicability of these considerations to the Federal procurement of the products involved.

Plaintiff's Interrogatory No. 9:

With respect to the contracts referred to in paragraph 4 of the Affidavit of Paul G. Dembling filed in support of the intervenor-defendant's motion for summary judgment, state

(1) the dollar value of the contracts, if any which were exempt from renegotiation under the Renegotiation Act of 1951, as amended;

(2) the total value of those contracts, if any, in which the contract price had been based on a standard catalog price or other indicia of adequate price competition;

(3) the total amount of "overpricing", if any, found to exist in any contracts included in your answer to Interrogatory 9(2); and

(4) the total amount of refunds recovered, if any, under those contracts covered by your answer to Interrogatory 9(2),

Answer to Interrogatory No. 9:

The contracts referred to in paragraph 4 of the Affidavit of Paul G. Dembling are Department of Defense contracts and subcontracts whose prices were negotiated on the basis of cost estimates supported by cost or pricing data submitted by the contractors in accordance with 10 U.S.C. 2306(f). Accordingly, none of these contracts would qualify for an exemption from the Renegotiation Act of 1951.

Since the prices of all these contracts were negotiated on the basis of cost estimates supported by cost or pricing data, it appears that none of the prices was based on standard catalog prices nor on adequate price competition. Therefore, no overpricing was found to exist in contracts in which the price was based on standard catalog prices or adequate price competition, and no refunds were recovered under such contracts.

Plaintiff's Interrogatory No. 10:

(a) State whether, prior to the commencement of the effort to conduct a survey of the economic facets, including cost and pricing practices, of the pharmaceutical industry, as described in paragraph 4 of the Affidavit of Gregory J. Ahart submitted in support of the intervenor-defendant's motion for summary judgment, the Comptroller General had ever asserted the authority to conduct a similar survey of any industry or portion thereof pursuant to 10 U.S.C. §§ 2306(f)(4), 2313(b) or 41 U.S.C. § 254(c),

(b) If your answer to Interrogatory 10(a) is in the affirmative,

(1) identify the industry or industries involved;

(2) state whether any such surveys were actually conducted and, if so, in which industries; and

(3) state which surveys, if any, involved the auditing of "catalog price" type contracts.

Answer to Interrogatory No. 10:

(a) GAO has been able to identify five examinations into industries where the Comptroller General asserted his authority pursuant to 10 U.S.C. 2313(b) to examine contractors' records.

(b) (1) The petroleum storage industry, the steel (production of HY80 steel plate) industry, the steel fabrication industry, the aircraft tire industry and the firearms industry have been examined.

(2) Surveys were conducted of each of the industries mentioned in paragraph (b)(1). Reports were issued as a result of each of the surveys.

(3) The survey of the steel (HY80 steel plate) industry involved catalog price contracts.

Plaintiff's Interrogatory No. 11:

(a) Describe the reasons why the GAO undertook the study referred to in Paragraphs 3 and 10 of the Ahart Affidavit.

(b) State whether any officer or employee of GAO has discussed, with any Member of Congress, orally or in writing

(1) the initiation of the study;

(2) the reasons for the study; or

(3) the status of efforts to pursue the study, including the conduct of litigation against Merck or other pharmaceutical companies, and

(c) Identify each conversation (including congressional testimony) referred to in your answer to Interrogatory 11(b) and each document discussing these subjects or recording or reflecting each oral conversation.

Answer to Interrogatory No. 11:

(a) GAO undertook the effort referred to in Paragraphs 3 and 10 of the Ahart Affidavit [this effort should be distinguished from the "more modest" study referred to in Paragraph 11 of the same affidavit] in order to gather and develop data necessary to provide a comprehensive and objective presentation to the Congress and involved Federal agencies concerning the salient economic and operational aspects of the industry. An objective GAO presentation concerning these matters would, in GAO's opinion, have been beneficial to agencies that buy and reimburse for prescription drugs as well as to the Congress in its efforts to determine whether the Government should consider alternatives to present policies and practices related to Federal drug procurement.

(b & c) GAO's continuing efforts to review Federal procurement systems for drugs and the operations of the drug industry have been the subject of some communications, both oral and written, between GAO officials and certain members of the Congress.

* * *

[page 17 of Interrogatories]

Plaintiff's Interrogatory No. 13:

(a) With respect to the letter from the Comptroller General to Merck's chairman, dated August 26, 1974, describe all types of documents in the possession, custody, and control of Merck which the GAO claims the right to examine and expects to examine in order to determine

(1) "support for prices charged to the Government" and

(2) "such other information as may be necessary for use to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government's interests."

(b) State whether the GAO claims the right under the "access to records" clauses in each of the subject contracts to examine any Merck records

(1) which do not explicitly relate to the products sold to the Government under each of those contracts, or

(2) which were not actually considered by the personnel of Merck who determined the prices at which to offer the products for sale to the Government.

(c) If your answer to either Interrogatory 13(b)(1) or 13(b)(2) is in the affirmative, explain why GAO believes such records are "directly pertinent" to the contracts.

Answer to Interrogatory No. 13:

(a) Defendants maintain that the right of access and examination by the GAO includes the following types of records:

(1) Records relating to those costs assigned by plaintiff to the products purchased under the subject contracts, which industry representatives have indicated are limited essentially to manufacturing costs.

(2) Records relating to those costs which, although they are incurred during the course of plaintiff's activities relating to the supply of ethical pharmaceuticals (including those purchased under subject contracts), are not assigned by the firm to individual products. These costs would include those incurred for activities such as research and development, marketing and promotion, distribution and administration.

(3) Records relating to the methodology, and decisions involved in plaintiff's establishment of prices for the products purchased under the subject contracts.

(4) Records required to verify, to the extent deemed necessary, all data obtained during the course of any review conducted.

These documents include those which support the prices charged the Government and which provide such other information as may be necessary to review the basis of the contract prices and the adequacy of the protection afforded the Government's interest. Since GAO representatives have not been provided access to records by plaintiff, it is not possible to identify more precisely the specific records which support prices charged the Government and which provide information regarding the basis for these prices and the adequacy of the protection afforded the Government's interests.

(b) In the answer to (a) above, the defendants describe as specifically as possible the records to which GAO claims access. Since GAO has not been provided access to records by plaintiff, it is not possible to say whether these records include records which do not explicitly relate to the products sold to the Government or which were not considered by personnel of plaintiff who determined the prices at which to offer the products for sale to the Government.

In any event, GAO believes that all records which relate to activities for which the plaintiff is incurring costs which affect the prices paid by the Government for items procured under the subject contracts or are necessary to verify the extent to which these costs affect the prices paid by the Government under those contracts are directly pertinent to those contracts. Further it is GAO's position that all records which are related to any of the considerations, whether or not cost related, which go into the setting of the price paid by the Government under the subject contracts are directly related to those contracts.

Plaintiff's Interrogatory No. 14:

State the years covered by the documents which the GAO claims the right to examine under the "access to records" clauses included in subject contracts, and specifically whether documents prepared more than

(1) two years

(2) five years

(3) ten years

(4) twenty years

prior to the award of each contract would be examined.

Answer to Interrogatory No. 14:

In the absence of having been afforded access to records not already publicly available regarding any cost or pricing activities relating to plaintiff's products, and in consideration of its need to verify any information which it might ultimately obtain from plaintiff GAO cannot state with specificity the time period covered by the documents which GAO claims the right to examine. However, the time period covered by the documents examined would be governed by the nature of plaintiff's pricing activities for the products purchased under the subject contracts and the pertinency of individual cost and pricing records to transactions relating to those contracts.

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

MERCK & CO., INC.,
Plaintiff,

v.

ELMER B. STAATS, Comptroller General
of the United States,
Defendant,

and

THE UNITED STATES OF AMERICA,
Intervenor-Defendant.

PLAINTIFF'S RESPONSE TO DEFENDANT AND INTERVENOR-DEFENDANT'S FIRST SET OF INTERROGATORIES

The plaintiff, by Philip H. Roy, Senior Vice President of Merck & Co., Inc., makes the following answers to the interrogatories propounded by the defendant and intervenor-defendant:

* * *

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Interrogatory No. 3:

Identify the costs incurred as a result of its operations by the Merck division(s), subsidiary(ies) or business component(s) identified in 2(a) above and the Merck division(s), subsidiary(ies) or business component(s) wherein each cost identified above is accumulated and/or recorded.

Response to Interrogatory No. 3:

MSD is engaged primarily in the manufacture, marketing and distribution of pharmaceuticals. Its manufacturing activities incur two categories of cost: inventoriable and non-inventoriable.

MSD uses a modified direct costing system in accounting for inventoriable costs. The latter include three elements—raw materials, direct labor, and certain variable overhead items —each valued at a standard cost based on periodic projections. Inventoriable costs can originate in any of 38 departments comprising three main production areas—pharmaceutical manufacturing, biological production, packaging operations—or in any of 27 direct service departments. The latter provide commodity or demand-type services to production departments, and include printed components, power, steam, quality control, equipment maintenance, materials receiving, and other services.

Non-inventoriable costs are expensed during the accounting period. These include such indirect manufacturing costs as depreciation, taxes on manufacturing facilities, building repairs, plant administration expenses, deletions and discards, inventory adjustments, materials management, and technical and general staff services.

All of the foregoing costs are accumulated and recorded in the accounting systems maintained in Rahway, New Jersey. Abstracts are available at MSD in West Point, Pa.

Interrogatory No. 4:

(a) Describe the methods used and the type of records kept by Merck in order for it to accumulate and record the costs identified in 3 above and indicate whether these costs are allocated or assigned to a division, subsidiary or business component, product line, product, class of customer and/or contract.

(b) If the costs identified in 3 above are not allocated or assigned as a part of Merck's cost accounting system to a division, subsidiary or business component, product line, prod-

uct, class of customer and/or contract is any such allocation or assignment made for any internal management purpose? If so, describe such allocation or assignment and the internal management purpose.

Response to Interrogatory No. 4:

(a) Methods used, and types of records kept by Merck to accumulate and record MSD pharmaceutical manufacturing costs are part of a company-wide system of budgeting, cost controls, and responsibility accounting.

Department heads budget their own costs, and subsequently control them within the framework of an approved budget. Costs are recorded within each department by element of expense (payroll, supplies, travel, publication, etc.). Department totals are grouped and summarized by area of responsibility and organization hierarchy. This budgeting and expense control is not product oriented.

Inventory cost standards include only those manufacturing costs that are directly assignable to products. This includes raw material, direct labor, and only that part of manufacturing overhead that is likely to vary with annual changes in product volume. All other manufacturing overhead (depreciation, taxes on manufacturing facilities, building repairs, etc.) is not accounted for on a product basis. When products are transferred from one division to another, the transfer is made at inventory standard cost. Other manufacturing overheads and service charges are not transferred among divisions.

Except for inventory valuation purposes, costs originating within MSD pharmaceutical manufacturing are not allocated or assigned as a part of Merck's cost accounting system to another division, or a subsidiary, business component, product line, product, class of customer and/or contract.

(b) Occasionally, depending on the nature of a special study, broad allocations of non-inventoriable manufacturing overheads are made "off books" for internal management. These may or may not include apportionments of all costs because the decision in question may not require that this be done.

Generally, the apportionment of the costs referred to above is related to total sales. To avoid creating the impression with management that all these costs have a common ratio to all sales, annually they are first grouped by major division. This grouping is then related to total sales of the division in order to obtain gross approximations or ratios applicable to the entire division. No attempt is made to develop specific ratios for individual products. Gross ratios are useful in subsequent studies such as product-oriented new capital additions or expansions, product evaluations prior to New Drug Application (NDA) or Bureau of Biologics (BOB) approvals. The apportionment of these costs in these studies provides some broad measure of the ability of new or expanded sales to contribute to these costs which, based on historical relationships, appear to have overall growth that is approximately the same as overall sales.

Merck management understands that such gross ratios may be calculated in various ways and may yield different results, and that there does not exist any generally accepted principle or method for such allocations, and accepts as fact that their use is limited solely for general information and trend data. As described in the Response to Interrogatory No. 4(a), control of costs and expenses is based on responsibility and organizational reporting.

Interrogatory No. 5:

(a) Identify each Merck division, subsidiary or business component engaged in advertising, promotion in the marketing and/or distribution of pharmaceuticals.

(b) Describe the operations of each division, subsidiary or business component identified in 5(a) above.

Response to Interrogatory No. 5:

(a) The "Merck Sharp & Dohme Division"

(b) (See Response to Interrogatory No. 2(b)). Pharmaceuticals are promoted by professional service employees who call on physicians and others concerned with the dis-

tribution and use of such products. Advertising is primarily in publications or other media directed principally to the medical professions. Sales are made primarily to drug wholesalers and retailers, hospitals, clinics, and other institutions.

Interrogatory No. 6:

Identify the costs incurred as a result of its operations, by the Merck division(s), subsidiary(ies) or business component(s) identified in 5(a) above and the Merck division(s), subsidiary(ies) or business component(s) wherein each cost identified above is accumulated and/or recorded.

Response to Interrogatory No. 6:

MSD is engaged primarily in the manufacture, marketing and distribution of pharmaceuticals. The following relates to MSD costs of marketing and distribution.

The costs of MSD marketing and distribution activities are expensed during the accounting period. Costs can originate in any of 51 departments comprising four main marketing and distribution areas—selling, branches, marketing and advertising, and the area comprising medical services and marketing and sales research.

All of the foregoing costs are accumulated and recorded in the accounting systems maintained in Rahway, New Jersey. Abstracts are available at MSD in West Point, Pa.

Interrogatory No. 7:

(a) Describe the methods used and identify the type of records kept by Merck in order for it to accumulate and record the costs identified in 6 above and indicate whether these costs are allocated or assigned to a division, subsidiary or business component, product line, product, class of customer and/or contract.

(b) If the costs identified in 6 above are not allocated or assigned as a part of Merck's cost accounting system to a division, subsidiary or business component, product line, product, class of customer and/or contract is any such allocation or

assignment made for any internal management purpose? If so, describe such allocation or assignment and the internal management purpose.

Response to Interrogatory No. 7:

(a) Methods used, and types of records kept by Merck to accumulate and record MSD advertising, promotion, marketing and distribution costs are part of a company-wide system of budgeting, cost controls, and responsibility accounting. Within MSD:

Department heads budget their own costs, and subsequently control them within the framework of an approved budget. Costs are recorded within each department by element of expense (payroll, supplies, travel, publications, etc.). Department totals are grouped and summarized by area of responsibility and organization hierarchy.

Advertising, promotion, marketing and distribution costs originating within MSD are not allocated or assigned, as a part of Merck's cost accounting system, to another division, or a subsidiary, business component, class of customer and/or contract. However, promotion expense is largely identified with products in the MSD budgetary control system. Additionally, a substantial portion of the total planned cost of professional representatives is allocated to products annually for planning purposes. The balance of MSD advertising, promotion, marketing and distribution costs are not allocated or assigned to products as a part of Merck's cost accounting system.

(b) Occasionally, depending on the nature of a special study, broad allocations of non-direct advertising, promotion, marketing and distribution expenses are made "off books" for internal management. These may or may not include apportionments of all costs because the decision in question may not require that this be done.

Generally, the apportionment of the costs referred to above is related to total sales. No attempt is made to develop specific ratios for individual products. Gross ratios are useful in subsequent studies such as product-oriented new capital addi-

tions or expansions, product evaluations prior to New Drug Application (NDA) or Bureau of Biologics (BOB) approvals. The apportionment of these costs in these studies provides some broad measure of the ability of new or expanded sales to contribute to these costs which, based on historical relationships, appear to have overall growth that is approximately the same as overall sales.

Merck management understands that such gross ratios may be calculated in various ways and may yield different results, that there does not exist any generally accepted principle or method for such allocations, and accepts as fact that their use is limited to general information and trend data. As described in the Response to Interrogatory 7(a), control over costs and expenses is based on responsibility and organizational reporting.

Interrogatory No. 8:

(a) Identify each Merck division, subsidiary or business component engaged in research and development activity in connection with pharmaceuticals.

(b) Describe the operations of each division, subsidiary or business component identified in 8(a) above.

Response to Interrogatory No. 8:

(a) Primarily the "Merck Sharp & Dohme Research Laboratories Division". The Merck Sharp & Dohme Division engages in a limited amount of development effort relevant to the manufacturing processes for finished dosage forms.

(b) The Merck Sharp & Dohme Research Laboratories Division conducts research programs designed to achieve scientific advances and new products as well as the improvement of or finding new uses for existing products. Scientific disciplines represented in the operation of this Division are organic chemistry, synthetic chemistry and pharmaceutical chemistry, biological sciences including molecular biology, pharmacology, toxicology and pathology, and medical science. Research projects related to human and animal health are conducted in

various fields such as bacterial and viral infections, cancer, cardiovascular functions, diabetes, gastrointestinal parasitism, inflammation, kidney function, the nervous system, mental health, animal nutrition, poultry genetics, fertility control, and ophthalmic research.

Regarding MSD see Response to Interrogatory No. 2(b).

Interrogatory No. 9:

Identify the costs incurred as a result of its operations by the Merck division(s), subsidiary(ies) or business component(s) identified in 8(a) above and the Merck division(s), subsidiary(ies) or business component(s) wherein each cost identified above is accumulated and/or recorded.

Response to Interrogatory No. 9:

Merck follows a policy of recording all of its research and development operating expenditures as expenses of the current period. R&D expenses are recorded on a departmental basis. Merck's Research Laboratories Division is organized into 77 different departments composed of, for the most part, people in similar scientific disciplines. In addition to expenses incurred directly by the employees of the Research Laboratories Division, services such as maintenance which are provided by other areas are charged on the books of account as R&D expenses.

All of the foregoing costs are accumulated and recorded in the accounting systems maintained in Rahway, New Jersey.

For purposes of conforming our external reporting of R&D to definitions of the National Science Foundation, which the pharmaceutical industry follows, "off the books" accumulation is made of all other supportive costs to develop total Company R&D costs.

Interrogatory No. 10:

(a) Describe the methods used and identify the kinds of records kept by Merck in order for it to accumulate and record the costs identified in 9 above and indicate whether these costs are allocated or assigned to a division, subsidiary or business

component, product line, product, class of customer and/or contract.

(b) If the costs identified in 9 above are not allocated or assigned as a part of Merck's cost accounting system to a division, subsidiary or business component, product line, product, class of customer and/or contract, is any such allocation or assignment made for any internal management purpose? If so, describe such allocation or assignment and the internal management purpose.

Response to Interrogatory No. 10:

(a) Methods used, and types of records kept by Merck to accumulate and record research and development activity in connection with pharmaceuticals are part of a company-wide system of budgeting, cost controls, and responsibility accounting. Within MSDRL:

Department heads budget their own costs, and subsequently control them within the framework of an approved budget. Costs are recorded within each department by element of expense (payroll, laboratory supplies, travel, publications, etc.). Department totals are grouped and summarized by area of responsibility and organization hierarchy.

Departmental costs are limited to those amounts spent directly by each department manager. Departments which render specialized technical or other services within the Company—such as analytical testing, glassware washing, data processing and accounting are responsible for controlling their own expenses based on demands on them for services. They do not charge out to other departments.

Research and development departmental costs incurred are not allocated or assigned as a part of Merck's cost accounting system to another division, subsidiary or business component, product line, product, class of customer and/or contract.

(b) For short-term planning records are kept of time spent by project against which average costs factors are applied for direct labor, materials, and research departmental overheads,

to arrive at estimates of project cost. Overheads for services and administration from departments outside of our Research Laboratories Division are not included in these estimates. Such estimates of project cost are useful for internal planning purposes.

Not until a chemical compound reaches the developmental stage can project cost be identified with specified products. However, even here the cost of unsuccessful developmental effort is not then reallocated to successes. Successful compounds which become additions to the product line are generally the result of many years of effort in multiple and/or overlapping fields of effort. As a consequence, total R&D expense, whether for one year or several years, is not allocated to specific products.

Occasionally, depending on the nature of a special study, broad allocations of research and development expenses are made "off books" for internal management. These may or may not include complete apportionments of all costs because the decision in question may not require that this be done.

Generally, the apportionment of the costs referred to above is related to total sales. To avoid creating the impression with management that all these costs have a common ratio to all sales, annually they are first grouped by areas of major effort under the categories of (a) Human, (b) Animal Health, and (c) Other. These groupings are then related to total sales of Human, Animal and Other products sold by major divisions to obtain gross approximations or ratios applicable to the entire division. No attempt is made to develop specific ratios to individual products. Gross ratios are useful in subsequent studies such as product-oriented new capital additions or expansions, product evaluations prior to New Drug Application (NDA) or Bureau of Biologics (BOB) approvals. The apportionment of these costs in these studies provides some broad measure of the ability of new or expanded sales to contribute to these costs which, based on historical relationships, appear to have overall growth approximately that is the same as overall sales.

Merck management understands that such gross ratios may be calculated in various ways and may yield different results, and that there does not exist any generally accepted principle or method for such allocations, and accepts as fact that their use is limited to general information and trend data. As described in Response to Interrogatory 10(a), control over costs and expenses is based on responsibility and organizational reporting.

Interrogatory No. 11:

(a) Identify each Merck division, subsidiary or business component engaged in general and administrative activity in connection with Merck's pharmaceutical business.

(b) Describe the operation of each division, subsidiary or business component identified in 11(a) above.

Response to Interrogatory No. 11:

(a) Merck Sharp & Dohme Division
Merck Sharp & Dohme Research Laboratories Division
Corporate (Division)

(b) Regarding MSD see generally Response to Interrogatory No. 2(b) and 5(b). Regarding MSDRL see generally Response to Interrogatory No. 8(b).

Certain general and administrative activity directly related to the operation of the Merck Sharp & Dohme Research Laboratories Division is provided by employees assigned full time to each Division. These Division employees, for each of their respective divisions, develop budgets, establish capital needs, handle the logistics of office and other space requirements and perform the usual administrative activity to the extent such activity is handled on a decentralized basis.

The greater portion of the general and administrative activity is performed on a centralized basis for the entire corporate entity, including both of the Divisions named above, by various departments within the Corporate Division. The departments are the Financial, Office of Corporate Treasurer, Management Information Services, Public Affairs, Legal, and

Personnel Relations. Each of these Departments performs for the Divisions the type of services normally associated with such departments, such as computer service by Management Information Services, employee benefit programs and other personnel activity by the Personnel Department, and legal matters by the Legal Department.

Interrogatory No. 12:

Identify the costs incurred as a result of its operations by the Merck division(s), subsidiary(ies) or business component(s) identified in 11(a) above and the Merck division(s), subsidiary(ies) or business component(s) wherein each cost identified above is accumulated and/or recorded.

Response to Interrogatory No. 12:

MSD is engaged primarily in the manufacture, marketing and distribution of pharmaceuticals. MSDRL is engaged in research and development operations. The following relates to MSD and MSDRL general and administrative costs, and the Corporate division.

Recording of general administrative costs in our books of account is done on a departmental basis.

Such costs typically include payroll, travel, books and periodicals, dues and memberships, machine rentals, supplies, and outside services. Additionally, some types of cost— principally depreciation, taxes, termination pay, and deletions and discards, are also recorded in divisional general and administrative accounts.

Corporate general administrative costs incurred fall into two main categories:

—Executive and supportive staff service areas, with expense elements typically consisting of payroll, travel, etc., and

—Miscellaneous expense and adjustments, which include such elements as interest, goodwill amortization, contributions, insurance, etc.

All of the foregoing general administrative costs are accumulated and recorded in the accounting systems main-

tained in Rahway, New Jersey. Abstracts of accounts relevant to the MSD operations are available in West Point, Pa.

Interrogatory No. 13:

(a) Describe the method used and identify the kinds of records kept by Merck in order for it to accumulate and record the costs identified in 12 above and indicate whether these costs are allocated or assigned to a division, subsidiary or business component, product line, product, class of customer, and/or contract.

(b) If the costs identified in 12 above are not allocated or assigned as a part of Merck's accounting system to a division, subsidiary or business component, product line, product, class of customer and/or contract, is any such allocation or assignment made for any internal management purpose? If so, describe such allocation or assignment and the internal management purpose.

Response to Interrogatory No. 13:

(a) Methods used, and types of records kept by Merck to accumulate and record general and administrative activity at MSD and MSDRL Divisions and in the Corporate area, are part of a company-wide system of budgeting, cost controls, and responsibility accounting.

Department heads budget their own costs and subsequently control them within the framework of an approved budget. Costs are recorded within each department by element of expense (payroll, supplies, travel, publications, etc.). Department totals are grouped and summarized by area of responsibility and organization hierarchy.

General and administrative costs originating within a division (MSD; MSDRL) or at the Corporate level are not allocated or assigned as a part of Merck's accounting system to another division, or a subsidiary, business component, product line, product, class of customer, and/or contract. An exception to this is domestic employee benefits, the costs of which are accumulated in one central group of accounts and subsequently

prorated to all departments covered by the plans as a standard addition to their actual payroll expense.

(b) Occasionally, depending on the nature of a special study, broad allocations of non-direct general and administrative costs are made "off books" for internal management. These may or may not include apportionments of all costs because the decision in question may not require that this be done.

Generally, the apportionment of the costs referred to above is related to total sales. To avoid creating the impression with management that all these costs have a common ratio to all sales, annually they are first grouped by major division. This grouping is then related to total sales of the division in order to obtain gross approximations or ratios applicable to the entire division. No attempt is made to develop specific ratios for individual products. Gross ratios are useful in subsequent studies such as product-oriented new capital additions or expansions, product evaluations prior to New Drug Application (NDA) or Bureau of Biologics (BOB) approvals. The apportionment of these costs in these studies provides some broad measure of the ability of new or expanded sales to contribute to these costs which, based on historical relationships, appear to have overall growth that is approximately the same as overall sales.

Merck management understands that such gross ratios may be calculated in various ways and may yield different results, and that there does not exist any generally accepted principle or method for such allocations, and accepts as fact that their use is limited to general information and trend data. As described in the Response to Interrogatory 13 (a), control over costs and expenses is based on responsibility and organizational reporting.

Interrogatory No. 14:

(a) Describe the methodology used in establishing catalog and contract prices for pharmaceutical products.

(b) Describe the extent to which the costs of the activities noted in questions 2(a), 5(a), 8(a) and 11(a) are considered in establishing catalog and contract prices.

(c) Identify all other factors considered in establishing catalog and contract prices for pharmaceuticals.

(d) Are weights or values attributed to each of the factors considered in establishing catalog and contract prices? If so, describe how these weights or values are applied to compare the relative importance of each factor.

(e) Identify and describe the records maintained by Merck concerning pricing decisions regarding individual pharmaceutical products.

Response to Interrogatory No. 14:

(a) There is no formalized methodology used by Merck in establishing catalog and contract prices. The Company has long been of the view that there is no precise or reliable way of determining the "real" fully distributed cost of creating, developing, producing, and selling a particular product in order to make sales prices cost-based. Instead, our prices are market-oriented. The major factors considered are the competitive situations in the particular market (i.e., available therapy), therapeutic benefits of our product for the patient and the potential rate of return to the Company. Our prices are intended to:

1. Offer the patient therapeutic advantages at a reasonable cost.

2. Permit us to compete effectively with currently existing therapy on a patient cost basis.

3. Provide a reasonable return to the Company.

In practice the pricing process begins with a careful study of the therapeutic alternatives presently available to the physician for use in the diagnoses for which our new product will have claims. Although this analysis is primarily concerned with alternative drug therapies, it also includes other forms of therapy (surgery, radiation, diet, etc.) which are widely used in the conditions where our new drug will have application.

For each drug or other therapeutic measure used to any extent, we will gather information on a number of both medical

and economic factors. These include: the degree of efficacy, the dosage schedule, the physical forms used (tablet, injectable, etc.), the manufacturer's prices and the cost to the patient (on a per day, course of therapy unit, or some other basis as seems appropriate to the problem at hand), the duration of therapy, and the expense of distribution.

Following this accumulation of information, we compare our new product candidate with each existing therapy on as many factors as is possible. Using the information available to us (clinical data, marketing research information, etc.) we determine the strengths and weaknesses of our product in the market. With this assessment and the competitive patient-cost information in hand, we determine, within a range, a price which meets competition, provides a reasonable premium for the added benefits of our product and provides us with the market penetration we feel this product should obtain.

It is at this point that we determine whether the total sales made at some price within the previously determined range and at expected volume levels are likely to provide us with a return for our investment. The calculation of this return is based primarily on the two specifics of selling price (derived in the manner described above) and inventory cost (as described in the Response to Interrogatory No. 3). In addition, if there are other direct expenses (as described in the Response to Interrogatory No. 6), these enter the calculation. Finally, rough approximations of all indirect costs and expenses (determined in the manner described in the answers to Nos. 4, 7, 10, 13) are used to develop a net return. This is related to the investment—composed of new direct capital expenditures (if any) plus allocations of indirect fixed and indirect working capital, both of which are determined on broad, rule-of-thumb bases.

The proposed price, once calculated as described above, is not adjusted at the completion of this process. The management decision is whether to market the product, in light of the anticipated return on investment, or not. The estimated rate of return on investment, however, is not an absolute "go-no go" determinant. It is an indicator of how the product, under the

assumptions used, compares with the Company average. Where there is a clear medical need for the product, we have developed and marketed it as a service to patients and the medical profession even though our estimated return is negligible or negative.

Changes in the price initially established for a product are the result either of competitive conditions or inflation, and are not the result of any later attempt to approximate indirect costs and expenses.

Contract prices are related to our retail or wholesale catalog prices. In sales to government agencies, the contract prices are based on the catalog prices, adjusted to reflect certain discounts depending on such matters as the quantities involved, the competitive pricing situation, our production capacity, and inventory situation. In the private market, our prices are based on our retail price catalog with one minor exception to non-profit hospitals.

(b) See generally Response to Interrogatory No. 14(a). Tentative prices are established without regard to Merck's costs. An approximation of costs is then used only as one factor in determining whether the product should be marketed at all. Cost analysis does not affect the basic price for the product.

(c) There are no other factors considered in establishing our prices other than those described in Response to Interrogatory No. 14(a).

(d) There is no mathematical or other system of weighing factors in determining a particular price. The various factors are considered but a final price results from a series of judgments and compromises. No one factor is considered to be more important than another factor as a general rule. The relative importance depends on the product, the needs of the patient, the availability of alternative therapies, etc. as described above.

(e) Records are maintained by product and subject matter. There are also files maintained which record our government bidding activities by customer, product and result.

* * *

[Page 38 of Interrogatories]

Interrogatory No. 16:

(a) Are revenues from Merck's sales of pharmaceuticals to the Government comingled with revenues from Merck's sales to other customers?

(b) If so, can Merck identify through its accounting system which revenues are generated from sales to the Government and which revenues are generated from sales to other customers?

Response to Interrogatory No. 16:

(a) Payments received for goods delivered under government contract are separately identified in our accounts receivable records. After the government account is credited with the amount of the payment, government checks are deposited in common Corporate cash accounts.

(b) Yes.

Interrogatory No. 17:

Do Government sales revenues cover, along with all other sales revenues, all business expenses incurred during a financial reporting period?

Response to Interrogatory No. 17:

Revenues from all sources, including sales to the Government, contribute to covering expenses incurred during a financial reporting period.

Interrogatory No. 18:

Do revenues generated from Government sales contribute, along with revenues from sales to other Merck customers, to the recovery of all costs of doing business during the period notwithstanding the fact that these costs may or may not be identified and assigned to any particular business segment, product line or specific product?

Response to Interrogatory No. 18:

Yes.

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Excerpt from Plaintiff's Response to Defendant and Intervenor Defendant's First Set of Interrogatories (Under Seal), filed October 8, 1975

Interrogatory No. 15:

(a) Does Merck prepare or cause to be prepared any document for any purpose whatsoever which is intended to show or evaluate the profitability of prospective or existing pharmaceutical products?

(b) Is any such document prepared or caused to be prepared in connection with the profitability of any Merck division, subsidiary or business component related to Merck's pharmaceutical operations?

(c) Does Merck, or any employee, have any document of the kind described in 15(a) above?

(d) If the answer to 15(a), (b), or (c) is affirmative, identify the documents.

Response to Interrogatory No. 15:

(a) Yes. See Responses to Interrogatories 4(b), 7(b), 10(b), and 13(b), above.

(b) Yes. See Responses to Interrogatories 4(b), 7(b), 10(b), and 13(b), above.

(c) Yes.

(d) See attached Schedules, which list documents covered by the request prepared on or after January 1, 1971. Identification of any earlier documents is objected to on grounds of excessive burden and irrelevance.

In addition, the attached schedules do not include all documents prepared as part of capital expenditure proposals. Such files are still being reviewed, and the Response to this Interrogatory No. 15(d) will be supplemented promptly upon completion of that search and the listing of any documents covered.

[The schedules include the following:

Fluax Profitability Analysis, dated 7-14-75

Fluax Profitability Analysis, dated 3-10-76

Blood Products Profitability Report, dated 6-12-73

Blood Product Contribution Report, dated 8-14-74

Product Line Profitability, dated 5-9-75

ELSPAR Profitability Study, dated 3-15-73]

IN THE

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

MERCK & CO., INC.,
Plaintiff,

vs.

ELMER B. STAATS, Comptroller General
of the United States,
Defendant,

and

THE UNITED STATES OF AMERICA,
Intervenor-Defendant.

Washington, D.C.
Tuesday, October 19, 1976

Deposition of:

GREGORY J. AHART

* * *

[Page 3 of Deposition]

PROCEEDINGS

Whereupon,

GREGORY J. AHART

was called as a witness by Counsel for the Plaintiff and, having first been duly sworn by the Notary Reporter, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. LACOVARA:

Q Shall we go on the record? Good morning, Mr. Ahart.

A Good morning.

Q Would you state your full name for the record, please?

A My name is Gregory J. Ahart.

Q And with what Agency are you employed?

A I am employed by the United States General Accounting Office.

Q What is your title?

A My Title is Director, Human Resources Division.

Q For what period have you held that title?

A I have held, essentially, the same position since April, 1972. In the interim, the name of the organization has been changed from the Manpower & Welfare Division and, in June of this year, to the Human Resources Division.

* * *

[Page 12, line 6 of Deposition]

Q you. Also, referring to your answer to Interrogatory No. 2, there is a statement made with respect to two other contracts that are involved in this suit; that it was determined that cost or pricing data was not necessary because the prices were based on established catalogue or market prices of commercial items sold in substantial quantities to the general public. Would you explain what that means in this circumstance?

A Well, Public Law 87-653 provides, as I indicated earlier, exceptions to the requirement for the submission of cost and pricing data.

One of those exceptions is in the case where the procuring agency determines that the product is one for which there are standard catalogue prices at which the product is sold in substantial quantities to the private sector.

Q This is regarded as being an indication of price competition?

A This is regarded as being an indication of the basic reasonableness of the price in the context that there are many different procurers of the product who are willing to pay that price.

Q Do you know whether the General Accounting Office is challenging that determination in this instance?

A To the best of my knowledge, the General Accounting Office is not challenging that assumption, per se.

Q Would you refer to the next exhibit, PA-2, which relates, I believe, to the remainder of your answer to Interrogatory 2.

This, as you will note, I believe is the contract—these are the contract documents from the Veterans Administration concerning the contract for which you said the VA determined that the administrative cost to receiving cost and pricing data would exceed the benefits that might otherwise accrue from procuring such information. Would you explain what that determination means?

The first page of PA-2 makes that determination and you paraphrased it in your answer on pages 3 and 4 of Exhibit PA-1.

A It seems that the explanation provided by the Contracting Officer, as recorded on the first page of Exhibit PA-2, is largely self-explanatory.

The Contracting Officer did make the determination that the administrative costs of securing cost and pricing data in this particular instance would outweigh any benefits that may accrue to the Government through obtaining the cost and pricing information.

* * *

[Page 21, line 6 of Deposition]

Q Coming now to the core subject matter of this law suit,

Mr. Ahart, can you describe for us how the General Accounting Office decided which contracts to assert access to records rights against Merck & Company?

These are the four contracts described in Mr. Staats August 26, 1974, letter to Henry Gasden, which letter is included in the Pleadings in this case.

A Yes. The basic selection process was to select contracts awarded by either the Veterans Administration or the Defense Personnel Support Center of the Defense Supply Agency within, I think, about the year prior to the August, 1974, letter which went to the President of Merck.

Q How were those contracts selected, do you know?

A They were selected on the basis that they were negotiated contracts which came within the purview of our access to records authority under the 1951 Act cited in the letter to the President.

Q Do you know whether Merck had more than four contracts that met those criteria?

A Not without refreshing my memory from our working papers I can't tell you that.

Q We will get to that in a moment and I will ask you more questions about it.

Let me ask, at this point, whether the GAO has any specific reason to believe that Merck made excessive or unreasonable profits on any of the four contracts in question?

A No. The General Accounting Office has no reason to believe that Merck made unreasonable or excessive profits on the four contracts.

Q And it is fair to say, on the basis of your response to the Interrogatories, specifically Interrogatory Answer No. 6, that the General Accounting Office has no reason to believe that anyone involved in the negotiation or performance of these contracts engaged in any impropriety or any violation of Federal statute or regulation?

A We have no reason to so believe.

* * *

[Page 25, line 14 of Deposition]

Q Is the second? That is, is this a spot check?

A This in, in effect, a spot check and it does derive from our responsibility to maintain general oversight over the activities of the Executive Branch of Government.

Q So the determination by the GAO to exercise access to records rights is, in this case, routine, would you describe it?

A It is routine in the sense that it falls within the purview of our regular responsibilities and activities.

Q You use the term "spot check" as a way of seeing that the system, and I presume this is the procurement system?

A This is correct.

Q Is working properly. Is your testimony that the decision to audit four Merck contracts is part of the normal process that the GAO uses to determine to spot check Government contracts?

A In a general sense, yes, it is a part of the overall spot checking system that we do use in the Federal procurement arena.

Q Did anyone suggest to you that General Accounting Office should conduct that spot check in the drug industry?

A It was suggested to us to give consideration to spot checking contracts in the drug industry.

Q Is this the first time the General Accounting Office is attempting to conduct spot checks in the drug industry?

A This is the first time that we are doing this kind of work in the drug industry.

Q How many companies, roughly, Mr. Ahart, sell pharmaceuticals to the Government?

A I don't have a reliable figure. There is a large number of companies that do sell pharmaceuticals.

Q Would it be closer to ten, fifty or a hundred?

A I would judge it is at least a hundred.

Q And how many companies has the GAO determined to spot check?

A We are presently attempting to spot check with respect to six companies.

Q Would you list those for me?

A The six companies are Hoffman LaRoche, Merck, Eli Lilly, Abbott, Bristol-Myers and SKF.

Q Would you describe how GAO selected those six companies?

A The six companies were selected on the basis that these companies had come forward, on a voluntary basis, to work with the General Accounting Office in what was referred to, at that time, as Phase I of a study of the economics of the drug industry.

* * *

[Page 34, line 8 of Deposition]

Q Now, I direct your attention to your Answer No. 11 to the Interrogatories in Exhibit PA-1 and ask that you read that answer to refresh your recollection.

A Uh-huh.

Q In the first paragraph of your answer, you describe one of the purposes of the study that planned as an attempt to gather and develop data necessary to provide a comprehensive and objective presentation to the Congress and involved Federal agencies concerning the salient economic and operational aspects of the industry.

Was the conduct of a study, with that objective, the result of your judgment that such a study was necessary?

A It was my judgment that such a study would be necessary. A judgment reached in consultation with members of my staff and others in the General Accounting Office.

Q When did you make that judgment?

A I would judge that the original judgment was reached probably during the latter part of 1971 or perhaps earlier in 1971, but was not firmed up and carried into a specific action until sometime later.

Q Do you recall whether anyone outside the General Accounting Office suggested that it might be desirable to conduct such a study?

A The study described in Paragraphs 3 and 10 of my Affidavit, my recollection is quite clear that no one outside the General Accounting Office suggested the desirability of that particular study.

Q What kind of study did someone outside the General Accounting Office suggest regarding the pharmaceutical industry?

A To the best of my knowledge, the only suggestion we received was to consider utilizing our access to records authority as provided for under the 1951 Act to look into the costs of producing pharmaceutical products by the drug industry.

Q And who made that suggestion?

A To the best of my recollection, that was made by Senator Nelson as Chairman of the Subcommittee on Monoply of the Select Committee on Small Business during testimony provided in January of 1971.

Q Has any Federal agency, other than Senator Nelson, requested that you perform this study?

A No Federal agency nor Senator Nelson requested that we perform this study which I referred to in Paragraphs 3 and 10 of my Affidavit.

Q Has any Congressional committee requested, in writing or in other formal means, that you conduct a study of the cost and profits of the pharmaceutical industry?

A There have been no direct requests from any Congressional committee for us to conduct a study of the costs of the pharmaceutical industry.

Q Would you say that all of the judgments that the GAO has made regarding whether to assert its access to records rights and, if so, on what terms have been made without any input or influence from any member of Congress or staff member?

A All of the judgments that have been reached by the General Accounting Office on this matter have been independent judgments by the General Accounting Office.

Q Have you taken into account the views of members of Congress or staff members in making those judgments?

A We are aware of the views of a few members of Congress and staff members on certain matters relating to the industry.

Q Which members would those be?

A Well, the only two members that I have personally consulted with or talked to on this matter are Senator Kennedy and Senator Nelson.

Q And what are their views?

A Their views are, basically—and I don't want to speak their views but their views, as I understand them, are that they feel that there is more knowledge needed in the public arena about the operations—about the pharmaceutical industry in general.

Q Information and knowledge in the public arena is necessary?

A Well, I'm basing this on the fact that both Senator Nelson and Senator Kennedy have held hearings in public session which had, as their objectives, the derivation of information about the pharmaceutical industry.

Q Is it your testimony that the assertion of access to records rights by the General Accounting Office, in this dispute with Merck, is not related to those efforts by Senator Kennedy and Senator Nelson?

A Well, it is indirectly related in the sense that we feel, also, as I have so stated, that there is a need for better information about the pharmaceutical industry to help the Government improve, if possible, its specific procurements of pharmaceutical products or system under which it procures pharmaceutical products.

Q Have you made any judgments, Mr. Ahart, about whether to conduct the spot checks and, if so, on what terms to conduct them on the basis of what you consider acceptable to Senator Kennedy and Senator Nelson?

A I have not made any judgments on the basis of what I would perceive to be acceptable by either of those gentlemen.

Q Are you aware of any discussions by members of your staff or other employees of the General Accounting Office on that question? Namely, what would be acceptable to Senator Kennedy or Senator Nelson or their staffs?

A I do recall—I don't know if this is documented or not but I suspect it is in some cases—that, with respect to some staff members, they made it very clear that the study we proposed to do under Phase I and Phase II was not particularly acceptable to them.

Q Why was that?

A Well, it was their judgment, and I don't know all the reasons for it, that they did not feel it would be particularly beneficial to the interest that they had.

Q What interests are those?

A I would not want to speak specifically for them as to —

Q What is your understanding of their interests?

A It was my understanding, based on the documentation and meetings, and perhaps some that I participated in, that at least one staff member felt that the public interest could be served by disclosure of product specific information, firm specific information with respect to the costs of manufacturing of products in relation to the prices which are charged.

Q Isn't that, Mr. Ahart, the core of the problem that, over the several years that these studies were under discussion, the General Accounting Office was trying to get the manufacturers to cooperate in the study and the manufacturers insisted on confidentiality of information and certain members of Congress and their staff, on the other side, insisting that you accept information only on the understanding that it could be made public?

A I don't think it is a question of what specific staff members insisted upon. It is a question of the relationship of the General Accounting Office to the Congress and, I guess, relationship of everybody else to the Congress in the sense that, although the General Accounting Office could assure each of

these firms that we would, to the best of our ability, not disclose any product specific or firm specific information and give them assurance that any report that we initiated on the basis of our work would not contain such information that would be identifiable with the firm, because we are subject, as most people are, to subpoenaes from committees of Congress and the Comptroller General has a statutory duty to be responsive to certain types of requests by committees, that we could not give a gold-plated guarantee, if you will, that we would not, in the course of events, be required to disclose some product specific or firm specific information.

Q Let me ask you this question: From the standpoint of the General Accounting Office and the reasons that you described earlier for conducting spot checks of Government contracts, could all the purposes of your office be satisfied by conducting these studies with an assurance confidentiality of the data?

A It would be my judgment that, yes, that could be done with the one exception that I would have to state. That if any of our work did disclose legal improprieties or anything of a criminal nature, obviously, we would have the responsibility to disclose that information to the proper investigatory law enforcement authorities.

Q Obviously. But putting aside what we have no reason to assume, I take it, that there might be some criminal impropriety uncovered, the GAO's function could well be served without the disclosure of specific confidential data to anyone?

A That's my judgment.

* * *

[Page 42, line 20 of Deposition]

Q Okay. Do you know whether the General Accounting Office adopted, as an objective of any of the durg industry, the objective of directing public attention to an individual item and to an individual drug manufacturer as suggested on what I have called page 6 of this Exhibit PA-11?

A I know that the General Accounting Office has never adopted that as an objective of work in this area.

* * *

[Page 52, line 10 of Deposition]

Q Have you ever done a study like this, of any industry, with a view toward making recommendations about how procurement ought to be handled in the future in that industry?

A I don't know of any study which has been exactly comparable to this. As I indicated earlier, it was based on the kind of understanding that grew out of our work and other people's work with respect to audits of non-competitive negotiated contracts which did lead to the passage of Public Law 87-653.

Q Were any industry studies involved in this work?

A One study that comes within my recollection which was associated with a specific industry in the product-type sense as opposed to the defense industry, which is much more broadly based, would be one that was done to help Congress out in a procurement policy matter about 1956 or 1957 or perhaps later with respect to the shipyard industry, shipbuilding industry.

Q Were there, in fact, recommendations made about changing the procurement of ships?

A I think my recollection is that the procurement policies were modified as a result of that study.

Q Any statutory modifications, do you know?

A To the best of my recollection, there was a statutory modification.

Q Dealing with shipyards?

A Dealing with shipyards.

Q But you are not aware of any industry studies? If you would like time to consult with your Counsel, I would be glad to give it to you.

(Discussion off the record.)

THE WITNESS: Referring back to my answer to Interrogatory No. 10, it appears the office has been able to identify

five examinations in industries where the Comptroller General has asserted his authority pursuant to the statute here involved.

I don't have any personal information, personal knowledge, of those five studies having not been involved with those.

Q Well, I am going to ask you to see if you can answer a few questions on those in a moment.

A (Nodding.)

(Whereupon, a luncheon recess was taken at 12:05 o'clock, p.m.)

AFTERNOON SESSION (1:25 p.m.)

BY MR. LACOVARA:

Q Let us go back on the record. Mr. Ahart, before we broke for lunch we were talking about any earlier studies the GAO may have done using its access to records rights into the economics of any industry.

You mentioned a study in about 1956 or '57 involving shipbuilding. Do you recall that statement?

A Yes, I do.

Q Can you give us more information about that study than you have already provided?

A My recollection is very vague about that study. As I recall, it was a request of one of the Committees on the Hill, and perhaps two, to examine into the justification for what, at that time, was a six percent differential which was given in favor of the west coast shipbuilding industry in their competition to obtain contracts on the basis that their costs were high. It was either the east coast or the west coast that got the differential and, as a result of our work on that study, which involved going to the contractor's plants and obtaining cost information, my recollection is that the statutory differential was repealed.

Q There was a differential in the statute?

A Yes.

Q That authorized the Defense Department to pay a higher—

A I think it was the Maritime Administration as opposed to the Defense Department.

Q I see. Construction of civilian shipping?

A Yes.

Q Do you recall whether or not, prior to the award of the contracts that you audited, the contractors were required to submit cost information?

A I have no recollection of that.

Q Do you recall whether or not access to records rights were asserted in doing that study?

A I have no recollection of whether that access to records clause was invoke or not in that particular instance.

Q Would contracts of that sort have included an access to records clause—that is, contracts by the Maritime Administration?

A I would suspect that those contracts would, at the time, but I couldn't say for sure.

Q Did the statutes that are at issue here, Title 10 and Title 41, apply to the Maritime Administration?

A Again, I would have to check that. They do have specific authority under the 1916 Act as amended.

Q The Shipping Act of 1916?

A As amended in 1936 for contracting authority and whether that comes under the purview of the Federal Regulations—whether or not that comes under the purview of either the Armed Services Procurement Regulations or the Federal Procurement Regulations, I am not sure.

Q Is it possible for you to infer, Mr. Ahart, that access to records clauses were not included in favor of the General Accounting Office from the fact that your answer to Interrogatory 10 does not make reference to any 1956 or 1957 shipbuilding study?

A It is quite possible.

Q You don't have any other explanation for why such a study would not have been included?

MR. BROSNAN: Can we go off the record for just one second ?

MR. LACOVARA: I would rather not.

THE WITNESS: No. I would assume that the access to records clause was not invoked in the 1956 or '57 study.

MR. EDGAR: That is not right.

MR. LACOVARA: If and when it becomes material, if we got an affidavit from somebody—

MR. EDGAR: Maybe we can clear it up on cross examination.

MR. LACOVARA: You are entitled to cross examine. If he knows, he can answer.

BY MR. LACOVARA:

Q Now, Mr. Ahart, I would like to direct your attention to your answer to Interrogatory No. 10 in Exhibit PA-1. Would you read over your answer to yourself, please?

A (Complying.)

Q Have you done so?

A Yes, I have.

Q Now, you are responding, there, to a question which asked whether GAO has previously asserted its access to records rights in order to conduct a survey of the economic facets including cost and pricing practices of any other industry, is that correct?

A That is correct.

Q Are you familiar with any of the studies that are referred to in your answer to Interrogatory No. 10?

A I am not very familiar with any of those five studies.

Q May I ask you to look at Exhibit PA-55 through PA-61. Can you tell me, Mr. Ahart, whether those reports marked Exhibits PA-55 through PA-61 are the reports that are referred to in your Answer No. 10(b)?

A From the titles, it would appear that some of them, at least, are related to parts of the answer to 10(b) but I would have to personally verify that.

Q Would you like an opportunity to consult with Counsel on that question?

A Yes, I would.

(Discussion off the record.)

THE WITNESS: It appears that these seven reports are related to the five examinations referred to in the answer to Interrogatory No. 10.

BY MR. LACOVARA:

Q Do you know whether the Comptroller General, in conducting those examinations, did, in fact, assert rights under the access to records clause and statute?

A In the context of the answer to Interrogatory No. 10, it appears that he did assert since the question was, did the Comptroller General pursuant to 10 U.S.C. 2313(b).

Q Do you know whether any other companies were asked to permit access to their records but refused such access in the course of conducting those studies?

A I have no knowledge of that.

Q Do you know that all companies asked did cooperate?

A I don't have personal knowledge on that.

Q So you can't draw a conclusion one way or the other? You might be able to by examining the documents?

A I am sure that the office could determine.

Q I won't ask any further questions on that, at this point.

As far as you know, there was no litigation commenced under the access to records clauses or statutes in connection with any of those studies, is that correct?

A As far as I know, there was not.

Q Referring you to your answer to Interrogatory 10, particularly Answer 10(b), you state that one of the studies involved was a study of what is described as the "firearms industry." Can you tell me whether the three exhibits which

have been marked PA-55, PA-56, and PA-57 are the reports that correspond with the study of the "firearms industry"?

A It appears that the three identified exhibits do relate to that. They all relate to the M-16 rifle.

Q And on their face, the reports deal only with a single item, namely, the M-16 rifle?

A From the report titles it would appear so.

Q Do you have any reason to believe that the reports or the studies which underlay the reports dealt with more than the production of the M-16 rifle?

A I have no knowledge of whether they did or did not.

Q The documents would speak for themselves on that?

A The titles of the reports indicate that only the M-16 rifle procurements were dealt with in the report. Whether or not surveys or reviews were made encompassing other things, I have no knowledge.

Q So if you were to examine the section of those reports, Exhibits PA-55 through PA-57, entitled "Scope of Examination," would you be able to tell how broad the survey was?

A I may be able to tell.

Q Could I ask you to examine each of those reports to determine if you can ascertain whether the study involved anything more than an audit of the contracts for the production of a single product?

MR. EDGAR: What page are you directing his attention to?

BY MR. LACAVORA:

Q I would ask you to look specifically on Exhibit PA-55 to page 24; in Exhibit PA-56, to page 21; and Exhibit PA-57, to page 3. Would you like those page numbers again?

A Did you say page 3 in Exhibit 57?

Q Yes. Page 3, I believe, in Exhibit 57, particularly the third paragraph in the section headed, "Introduction." The

paragraph begins, "We examined Colt's accounting records and other data relating to its methods for estimating prices for inclusion in contract proposals under the major M-16 rifle program contracts during the period 1964 through 1967."

A With respect to Exhibit PA-57, it would appear from the scope information on page 3 that the survey and/or review was restricted to the M-16 rifle program.

With respect to Exhibit PA-56, the scope, as described on page 21, does not allow me to reach a conclusion because it uses the words, "Our review was primarily concerned with," and I don't know with what else it may have been concerned.

On page 24 of Exhibit PA-55, again, I can't reach a conclusion because it states, "Most of our audit efforts were spent at the GM production site," and does not refer specifically to the M-16 program.

Q All right. I would ask you to review the Table of Contents of each of those three exhibits to see whether they suggest to you any place in which the economics of the firearms industry, in general, are addressed or the profitability of that industry is addressed, or the profitability of any of the three companies involved is addressed.

MR. EDGAR: That is nine different questions.

MR. LACOVARA: Yes. I think there will be an overall answer "No," but, if the witness says, "Yes," as to any part, I will ask them individually.

THE WITNESS: Would you restate the three items that you would like answers to with respect to each of the three exhibits?

BY MR. LACOVARA:

Q Okay. With respect to each of the three exhibits, is there anything which suggests to you that the reports deal with, one, the economics of the firearms industry in general; two, the profitability of the firearms industry in general; or, three, the profitability of any of the three companies involved in the audit?

A Just for point of clarification, you are directing my attention only to the table of contents of each of the three exhibits?

Q We will start with that, yes.

A I see nothing in the table of contents which bears directly on any of the three items that you mentioned.

Q Is there any other place that you would like to look at that might allow you to give a categorical answer to those questions?

A Well, I think, since the answer to Interrogatory No. 10 apparently deals collectively with three examinations involving different firms, you would have to deal in the context of the collective three reports and, more importantly, the basic content of the review work that was done.

Q Well, that is really my question, Mr. Ahart. The Interrogatory asks whether you are aware of any studies that the General Accounting Office had done into the economic facets of an industry and you have identified for us three reports done at three different companies which happen to make firearms and each report deals only with the M-16, and I am only trying to find out whether there is anything in the reports that deals with the industry as an industry.

MR. EDGAR: Wouldn't a fair answer to that be that the reports speak for themselves and whatever they say, they say.

MR. LACOVARA: Well, I would like to know what the witness' understanding was of the question that led to the answer that these three reports involved an examination of an industry rather than an audit of three contracts for the same product.

THE WITNESS: Well, in the judgment of the people who furnished the information to me, as identified in the next to the last page of the set of Interrogatories, they must have judged that they were concerned with the economics of industry, however you may define that term "industry."

I am not familiar, however, personally, either with the contents of the studies or the content of the report or with the make up of the "firearms industry" to make a personal judgment on whether the answer here is responsive to the intent of—as opposed to the words—the composers of the Interrogatories.

BY MR. LACOVARA:

Q You cannot make that judgment?

A I cannot make that judgment.

Q Let me ask you this: If you were to do an audit of three contracts with three different drug companies for the same product—let's say a flu vaccine—would that, in your judgment, constitute a survey of the economic facets of the pharmaceutical industry?

A In my judgment, it would not.

Q Can I refer you to Exhibit PA—before we pass to that, Mr. Ahart, let's stay with Exhibits PA-55, 56 and 57, for a moment, and I would like you to look at the first page of each of those exhibits or, at least, what I call the first page called "Digest," which I assume is a summary that you provide to the readers of these documents so they will have an overview of what is involved and, after you have looked at the headings, "Why the Review Was Made," I am going to ask you a question.

A I have read the three provisions.

Q Is it possible for you to determine, from the portions to which I have just directed your attention, whether each of these contracts was negotiated on the basis of cost and pricing information that was submitted to the contracting agencies?

A With respect to Exhibit PA-55 and Exhibit PA-56, it is clear that cost and pricing data was submitted. With respect to PA-57, it is not clear to me whether it was or was not.

Q All right. With respect to PA-57, would you direct your attention, please, to page 16 and read the first half of that page to yourself, please?

A I have read it.

Q Are you now in a position to state, with respect to each of the contracts audited and reported upon in the three exhibits, that cost and pricing information had been submitted at the time of the award?

A The reports make clear that they were.

Q Is it possible to conclude, from the first page of the Digest Section of each of these reports, that the reason why the review was made was to ascertain whether suspicions about the accuracy of cost and pricing information should be verified?

A It is clear that concern with the negotiated price was present in each of the three cases.

Q Well, not negotiated price. The cost and pricing information that was submitted.

For example, directing your attention to PA-55, under the heading "Why the Review Was Made," there is a statement, "A Special Subcommittee of the House Committee on Armed Services recommended that the General Accounting Office closely audit the cost and pricing data submitted by GM in support of the contract price."

A Again, this is clear with respect to Exhibits 55 and 56. With respect to Exhibit 57, it appears the concern was whether there was some circumvention of the statutory requirements laid down by public law 87-653.

Q Those are the requirements of the Truth in Negotiation Act relating to the submission of cost and pricing information?

A That is correct.

Q Now, I ask you to refer to Exhibit PA-58. I assume that you have no personal knowledge of the information underlying this report either, is that correct?

A That is correct.

Q By examining the first two pages of this report, can you ascertain whether or not these contracts were negotiated on the basis of cost and pricing data submitted during the negotiations?

A You are referring to the first two pages of the reports?

Q Of the text entitled, "Report on Examination."

A Would you restate your question, please?

Q My question is, can you ascertain, from looking at those pages or any other portion of Exhibit PA-58, whether or

not the contracts that were reviewed were awarded after the submission of cost and pricing information?

A It would appear that it was not awarded after the submission of cost and pricing information pursuant to the requirements of the Truth in Negotiation Act.

In fact, it would appear that the contracts predated the enactment of Public Law 87-653. It does make reference to the fact that, as part of our study or our examination, we analyzed the cost estimates that were included in negotiated prices as distinct from looking at cost and pricing data submitted and certified by the contractor.

Q Right. I understand that these were pre-Truth in Negotiation Act cases but you stated, I believe, that cost and pricing information was submitted as part of the negotiation process and that was what was the subject of your audit?

A The document refers to cost estimates included in the negotiated process and I can't go beyond those words to amplify their meaning.

Q Do you know what the purpose of the audit was that is reported in PA-58? And perhaps it would aid you in answering the question to direct your attention to the transmittal letter to the President of the Senate and the Speaker of the House, which is the first document in Exhibit PA-58.

A (Reading document.)

Q Is it a fact, Mr. Ahart, that the report deals exclusively with the question of the relative cost to the Government of using commercial petroleum storage facilities as opposed to using Government facilities?

A It appears that the thrust of the study was to evaluate the relative economy to the Government of using new commercial storage facilities as compared to utilizing Government facilities for the storage of petroleum.

Q Is there anything in this report that indicates that the GAO's review was designed to be or was, in fact, a study of the economics of the petroleum storage industry?

A I can't speak for everything that is in this report. I have not read the report in full.

From the parts that we have looked at, in my personal judgment, it would not be a broad gauge look at the economics of the total industry but it certainly delved into the economics of one part of the industry to the extent necessary to make the determination or the relative evaluation which you have just referred to.

Q How do you draw that latter conclusion?

A It did look at the cost incurred, as I understand the language here—the cost incurred by the Government in the utilization of commercial storage facilities.

Q Is there anything in there, that you are aware of, about the profitability of the oil storage industry?

A Again, I have not read the full report and I don't know if there is anything in there on the profitability of that portion of the industry.

Q Is the GAO undertaking its study of the six drug companies that are involved in the current discussions for the purpose of determining whether the Government would benefit economically from manufacturing its own drugs rather than procuring them commercially?

A We have not contemplated that kind of comparison at all. We are trying, as I stated before, to get an understanding of the drug companies as they relate to Government procurement of pharmaceuticals to determine whether there are ways that we might recommend improvements in the Government's procurement process.

Q But, as we discussed earlier this morning, you don't know what you might be proposing?

A That is correct.

Q If anything?

A That is correct.

Q It is entirely conceivable that, at the end of this process, assuming it does go forward, you may have no recommendations?

A That is conceivable.

Q You may conclude that the present system is great?

A That is conceivable.

Q Would it surprise you to reach that conclusion?

A Since I have made it clear that I don't have any specific expectations, I would not be subject to the element of surprise.

Q You are encouraging openminded, I am happy to note. Thank you.

I would like to move quickly through the last of these reports. Exhibit PA-59. This one is clearly enough marked and related to in your answer to Interrogatory No. 10.

It appears to deal with the procurement of aircraft tires. This is, I believe, the report that you had in mind, or that someone had in mind, when the Answer 10(b) speaks of the aircraft tire industry, is that correct?

A It appears to be correct.

Q By looking at page 1, the transmittal letter to the President of the Senate and Speaker of the House, can you tell, from Exhibit PA-59, whether the report is analysis of GSA contracting procedures for establishing prices for aircraft tires and, perhaps, in responding to the question, you would also like to look at the table of contents under the heading, "Findings and Conclusions"?

A The main thrust of the report seems to be the need for improvement in the way the General Services Administration procured aircraft tires basing, to some degree, the need for improvement on reference to the better systems utilized by the Air Force and the Navy in procurement of the same commodity.

Q Is there anything in Exhibit PA-59 that suggests to you that the review was designed to be or was, in fact, a review of the economics or profitability of the aircraft tire industry or of any aircraft tire company?

A Having not read the whole exhibit, I could not answer your question. There is a suggestion that, on the first page of

the transmittal letter, the need for improved methodology in procuring aircraft tires on the part of the General Services Administration was predicated, at least in part, on, as stated here, an obvious lack of effective price competition among the six main suppliers of this commodity, which does get into, I think, the economics of that particular industry.

Q Anything in there about profitability?

A In the transmittal letter itself, I see no specific reference to profitability. Again, I have not read the full report.

Q Can you tell, from referring to answer to Interrogatory 10, whether or not it is accurate to state that the contracts reviewed in Exhibit PA-59 were not catalogue price contracts and that, therefore, they were not exempt from the submission of cost and pricing data at the time of negotiation?

A Your reference is to Exhibit PA-59?

Q Yes. If you will consult your answer to Interrogatory No. 10, you will see that there is a question whether any of the surveys that we asked about involved the auditing of catalogue price type contracts and your Answer No. 10(b)(3) states that only the steel industry report involved catalogue price contracts. Is your answer, then, that—

A The indication would be that the subject of the procurements dealt with in Exhibit PA-59 would not involve catalogue price contracts but that is not germane to the issue of the cost and pricing data since the awards here obviously predated the Public Law 87-653.

Q Can you tell whether or not cost and pricing data were, in fact, submitted?

A It states that the General Services Administration did not request cost data or other evidence to support the reasonableness of the prices quoted.

It also appears that perhaps the Air Force and the Navy did.

Q All right. I would like to direct your attention to PA-60 which is captioned, "Questionable Pricing of Contracts Negotiated for Urgently Needed Bomb Bodies."

I ask you whether this is the report that deals with what is described in your answer as the steel fabrication industry?

A This appears to be that report.

Q Do you know of any other reports dealing with the "Steel Fabrication Industry"?

A I have no personal knowledge of any.

Q Would you conclude that, in examination of the procurement and supply of bomb bodies, that would allow you, as an accountant and as a senior official of the General Accounting Office, to comment on the economics of the steel fabrication industry?

A Again, I am not personally familiar with this study referred to. I have no personal knowledge of any depth the makeup of the steel fabrication industry and what part the fabrication of bomb bodies plays in that industry. So I really have no judgment on that.

Q May I ask you to look at page 1 of the Exhibit PA-60, the Digest Section, particularly the section entitled "Why the Review was Made."

A I have read that portion.

Q Can you tell from that section of PA-60 or from any other portion of this exhibit whether the GAO review involved more than auditing the contract for one specific military item, namely, military bombs?

A It appears that the General Accounting Office examination reported on in Exhibit PA-60 was restricted to the procurement of bomb bodies.

Q All right. Either from your general knowledge as a citizen, Mr. Ahart, or from any portion of the report, can you state whether or not military bombs or bomb bodies are items that are catalogue price items sold to the general public in substantial commercial quantities?

A My judgment would be that they probably are not, but there are some elements of our general public which I am not fully cognizant of.

Q We would agree, hopefully, that substantial quantities are not sold?

A I would hope that you are correct.

Q In any event, can you tell, from the section to which I just directed your attention, whether or not cost and pricing data were, in fact, submitted during the negotiation of the contract?

A The contracts were subject to the Truth in Negotiation Act and it appears that the contractors did submit and certify to the cost and pricing data.

Q In Paragraph 3 of the Introductory Section, "Why the Review was Made," it states that it was the purpose of the GAO to evaluate the reasonableness of significant estimates accepted by the Navy in relation to cost data available to the contractors at the time of each negotiation. Is that correct?

A Well, that is not a direct quote. It is a statement depending on where you started your quote, but it does state that the examination was directed to evaluating the reasonableness of significant estimates accepted by the Navy in relation to cost data available to the contractors at the time of each negotiation.

Q Can you conclude from that statement, and anything else you would like to examine in PA-60, whether the purpose of the examination was to verify the accuracy of cost information submitted during the negotiation process and the propriety of the contracting agency's acceptance of that cost information?

A It does not mention the term "accuracy" here. It is evaluating the reasonableness of significant estimates accepted by the Navy in relation to cost data available to the contractors at the time of each negotiation and, again, I am not in a position to amplify any of those words.

Q But the focus was on the reasonableness of estimates of cost?

A That is what it states.

Q Examining Exhibit PA-60 in as much detail as you consider appropriate, can you state whether or not there is

anything in this report that indicates that it was the design of the GAO survey, or the effect of the GAO survey, to report upon the economics of the steel fabrication industry or about the profitability of that industry or the profitability of any individual steel fabrication company?

A Well, without actually examining the document to the extent I would consider necessary to reach that determination, I would not be able to answer your question as posed.

Q Is there anything that you can find in the table of contents or elsewhere that suggests that the answer to my multipart question is, in any respect, yes?

A I have not taken the time to look at the "elsewhere."

Q Well, would you like to look at the table of contents to see whether it would give you a clue as to some section you would like to glance at?

A The table of contents doesn't give me any clue as to any specific section I would like to glance at, but the table of contents is also a very brief set of captions which would not allow me to reach the judgment that you are asking me to reach.

Q Let me put it this way: Do you have any reason to believe that this survey was, in fact, a study of the economics of the steel fabrication industry or the profitability of the industry or the profitability of any individual company that maybe involved in steel fabrication?

A I have neither any reason to believe it or disbelieve it without doing the kind of research that it would take to answer the question.

I do have reason to believe that the supplier of the information which is incorporated in the answer to Interrogatory 10, based on his interpretation of intent and meaning of Interrogatory No. 10, felt or believed that this study was within the meaning and intent of the person posing the Interrogatory.

Q But you can't reach that judgment?

A I cannot reach that judgment without studying the document and knowing what was actually incorporated in the examination which supports the document.

Q Can I ask you to describe the process that you went through before you signed and swore to the accuracy of these answers, Mr. Ahart, with particular reference to answering Interrogatory No. 10?

A With respect to answering Interrogatory 10, the different divisions in the office were asked to research their past work to see if they could identify studies which they believed to be within the scope of Interrogatory No. 10 and to come forward with that information.

My recollection is that this specific information, in consultation with our Office of General Counsel, was furnished by representatives of our Procurement and Systems Acquisition Division drawing on records of the former Defense Division.

Q All you can say, then, is that someone, somewhere in GAO, decided that a study of the procurement of bomb bodies constituted a study of the steel fabrication industry, is that correct?

A Well, at least it was a judgment that the identification of the study would be responsive to the perceived intent of Interrogatory No. 10.

Q What is your judgment?

A In consultation with, obviously, our General Counsel.

Q What is your judgment on the basis of what we have just discussed? Namely, that this appears to involve an examination of contracts for the procurement of two sizes of military bombs.

Would you, as an accountant or senior official of the General Accounting Office, say that that constitutes a study of the economic facets of the "steel fabrication industry"?

A Well, it certainly gets involved in some economic facet of the steel fabrication industry. As I stated before, I don't have enough personal knowledge of the makeup of the steel fabrication industry, whatever it is, or of the specific scope and procedures followed in this study to make my own personal judgment on that.

Q Let me put it this way: If you had examined two contracts for the procurement of pharmaceutical drugs, would

you think that you could state that you had performed a survey of the economic facets of the pharmaceutical industry?

A Having some knowledge of the pharmaceutical industry, no, I would not.

Q Thank you. All right. Moving along to the last of our reports, may I ask you to look at Exhibit PA-61? Is this the report that relates to what you have described in your answer to Interrogatory No. 10 as a report on the study of the "Steel (Production of HY80 Steel Plate) Industry"?

A It appears to be that study or the report on that study.

Q In your answer to Interrogatory 10, particularly Paragraph (b)(3), you state that this survey involved catalogue price contracts. May I ask you to refer to pages 10 and 11 of Exhibit PA-61 and tell me whether you would like to qualify that answer?

A (Reading document.)

Q Have you had a chance to examine pages 10 and 11?

A I have glanced through 10 and 11 but I think there also may be information on previous pages which is pertinent to the question.

Q Please take the time to look at it.

A I think a statement, here, perhaps, involves attributation to the question. The question was, "state which surveys, if any, involved the auditing of "catalogue price" type contracts."

From the information and the statement in answer to that Interrogatory, it states, "The survey of the steel (HY80 steel plate) industry involved catalogue price contracts."

The reference on page 7 of Exhibit PA-61 that the caption reads, "HY80 steel plate purchased at identical catalogue prices," and a reference on page 10, at the top, "The designation of HY80 steel plate as a catalogue item for pricing purposes on Government contracts is not justified."

So, without looking further, I would surmise that they were, in fact, negotiated on the basis of catalogue prices.

Q In Federal Procurement Law, Mr. Ahart, what does it mean to say when something is a "catalogue priced item"?

A Well, under the terms of the Truth in Negotiation Act,—the statute couples the fact of catalogue prices together with the substantial sale of the commodities to the general public.

Q Yes. But what does it mean to be a "catalogue price item" without getting into whether or not the items are sold to the public?

You just read to us from page 10 of PA-61, a finding by your office.

A My judgment would be, if there is a catalogue price established, there is a catalogue price involved.

Q You have read to us, from page 10 of Exhibit PA-61, a determination by the General Accounting Office that it was not proper to designate those or to treat it as a catalogue item because the product is sold almost exclusively to the Government and its prime contractors.

Does that provide any illumination as to what, in Federal Procurement Law, a catalogue item is considered to be?

A I think it is a judgment on the reference at the top of page 10 of the report. It appears to be a judgment of the General Accounting Office that the catalogue price exception, if, in fact, used in this instance, is not appropriate because the product is sold almost exclusively to the Government and its prime contractors.

Q So, what was involved here was an audit of the supply of a particular product. Namely, the steel plate used for nuclear submarines and naval vessels that is almost exclusively sold to the Government, is that correct?

A The statement is, "sold almost exclusively to the Government and its prime contractors."

Q But there is virtually no commercial market for it among private purchasers?

A I would assume that we could characterize "prime contractors" as "private purchasers." I wouldn't want to get into—

Q A "prime contractor" I take it, in this context, is someone who is manufacturing a product for sale to the Government, is that not correct?

A That is correct.

Q For sale exclusively to the Government and its prime contractors?

A That is correct. But prime contractors can also have non-Government business and, without knowing more about it, I wouldn't venture a judgment on the validity of your hypothetical statement.

Q I don't want to spar with you on this but I think if you will look at pages 11 and 12, at the bottom of 11 and top of page 12 of Exhibit PA-61, you will see that the context suggests that your report—that is, the report of the General Accounting Office—is referring to prime contractors in their capacity as contractors for the Federal Government in building naval ships.

A You are referring to the bottom of page 11?

Q Yes.

MR. EDGAR: I think you are suggesting that you not spar with him. Why don't we just let these documents speak for themselves?

MR. LACOVARA: I will agree to that suggestion.

BY MR. LACOVARA:

Q Mr. Ahart, a final question on these reports. Is there anything in this report that suggests to you that this study was intended to be or was, in fact, a study of the economics of the steel industry or of the profitability of the steel industry or of the profitability of any particular steel company?

A Again, not having read in full the document identified as Exhibit PA-61 and not being familiar with the specifics of the study that underly that document, I cannot answer the question as posed.

Q Can you make a judgment whether or not the auditing of contracts for a particular kind of steel would lead the General Accounting Office to make a judgment about the economics or profitability of the steel industry as a whole?

A I suspect it would not. Although I think, for the purpose of clarification, I should point out that the steel, in

answer to Interrogatory No. 10, is the steel (production of HY80 steel plate) industry.

Q Well, if you want to define the industry by the supplying of a particular product, I assume this would be a study of the HY80 industry, is that correct?

A I can't, again, without making more of a study of the document, make a judgment of whether it is or isn't that.

Q Would you consider the auditing of the supply of a particular vaccine, for example 'flu vaccine, sufficient basis for you to make a judgment about the economics of the pharmaceutical industry?

A I think I have answered that about twice, at least, before, and the answer is, no.

Q And your answer is still the same?

A Yes.

* * *

[Page 90, line 20 of Deposition]

Q Well, let me ask you this question as clearly and concisely as I can: Is it your understanding of the position of the General Accounting Office that the Subcommittee, of which Mr. Gordon is Staff Director, would have the right to obtain, from the General Accounting Office, any information the General Accounting Office may obtain in the course of performing these studies that are the subject of this law suit?

A As I indicated in answer to your previous question, I haven't researched the jurisdictional base of that Subcommittee or the full Committee, for that matter, of which it is a Subcommittee and, when it comes to subpoenaes, I think that, if a subpoena should issue from that Committee, it would be probably not a situation which we would question.

If the Committee decided it had that jurisdictional base, I would not question that jurisdiction.

Q That would put you between the rock and the hard place, wouldn't it?

A I think that we would be responsive to any subpoenaes, if we could, that were issued from the full Committee.

Q Putting aside the subpoena, however, suppose Mr. Gordon picked up the telephone and asked you for information that you might develop in the course of doing a study, what would be your position?

A Our position would be—

Q Of whether he should receive that information?

A If Mr. Gordon picked up the telephone and asked me for that information, I would tell him that he may not have it.

Q Why would you say that to him?

A Because Mr. Gordon is a staff person on the Hill and cannot—is not empowered to demand, and I have no responsibility to be responsive when, in my judgment, the information should not be released.

Q Suppose Senator Nelson picked up the telephone and made the same request?

A I think the answer, in that case, based on discussions that I have had with the Comptroller General, is that we would not respond to Senator Nelson as such, based on a telephone conversation.

Q What would we have to do in order for you to respond and to supply the information we've described?

A Well, the situation would have to be tantamount to a subpoena situation where it was clear that the Committee, of which that Subcommittee is a part, made the judgment as a Committee that the information was necessary for the conduct of their responsibilities.

Q Would that involve a Committee vote?

A Yes. I think if I understand the Comptroller General's thinking, or it is my thinking, that we would want to be assured that it was, in fact, the concensus of the Committee and whether we could be assured short of a Committee vote, I wouldn't want to speculate, at this point.

Q This Committee that we are referring to, Mr. Ahart, is the Select Committee on Small Business?

A That is correct.

Q Would you satisfy yourself that that is the Committee under which the various statutes, to which you have referred, is the Committee which is authorized to demand this information?

A As I indicated earlier, I think, if it got to the point where it is tantamount to a subpoena or is clearly the sense of the full Committee, I would not think that we would question the jurisdiction. Particularly in this case where small business is a very broad jurisdiction, no matter which way you want to interpret the term "small business."

Q Do they have any authorization responsibilities?

A The Select Committee on Small Business, it is my understanding—and I wouldn't want to be held to this—that they have no legislative power.

Q So they have no power over the authorization for the expenditure of public funds, in your understanding?

A Again, my understanding is they have no legislative power, as such. In other words, they are not authorized to report out legislation to the full Senate.

Q And they have no appropriations authority?

A The appropriations authority is centered in the Appropriations Committee.

* * *

[Page 109, line 19 of Deposition]

Q Well, without having to go over the individual documents, Mr. Ahart, do you have any question in your mind that it was the desire and intention of Senator Nelson and Senator Kennedy to obtain individual company cost data if the General Accounting Office obtained it?

If you like, you can refer to Exhibits, I think it is, 12 through 33 which track the three-year history of this question, before you answer.

A You are asking me if it was the intent of Senator Nelson and Senator Kennedy?

Q No, sir. Was it and is it your understanding of their intention that they desired to obtain, from the General Accounting Office, individual company cost information if the General Accounting Office obtained it?

A I have no understanding of either Senator Nelson or Senator Kennedy's intention in this regard, much less that of the Subcommittees of which they were the head.

Q All right. We will go through the documents, then. The document PA-26 states that "Mr. Staats agreed to meet with Senator Nelson and Senator Kennedy to ascertain the likelihood that they would request GAO data not contained in our planned report."

Do you know whether Mr. Staats did, in fact, meet with either Senator Kennedy or Senator Nelson on that question?

A There were meetings held with both Senator Nelson and Senator Kennedy subsequent, in that year, in August, to the best of my recollection by Mr. Staats.

The specific purpose of those meetings were not to discuss, to the best of my recollection, this particular question but to advise them that we felt that we had reached an impasse with the industry representatives in going forward on a voluntary basis and that we planned to issue formal letters of demand.

Q So it is your testimony that Mr. Staats never did hold the meeting that it was agreed he would hold?

A This specific meeting here?

Q Yes.

A To the best of my recollection, that is the case.

Q Do you know whether anyone else met with Senator Kennedy or Senator Nelson to ascertain the likelihood that they would request GAO data?

A There were meetings held and I am sure the documentation would support this. One of which, at least, I attended with the staff members of the Subcommittees in the persons of Dr. Horwitz on Senator Kennedy's Subcommittee staff and Mr. Ben Gordon on Senator Nelson's Subcommittee staff and they made it very clear to us, and represented this to be the views of

both the Senators, that they would frown upon any promise on our part as a part of trying to seek voluntary participation by industry—any promise on our part not to disclose information. To never disclose information at the request of either Subcommittee.

Q Do you know when those meetings took place?

A To the best of my recollection, those were probably in May of 1974—May or early June. Perhaps late April. It was in that time period.

Q It is customary in this line of work, is it not, Mr. Ahart, to accept the representations of staff members of Senators or Congressmen as reflecting the positions of their members, is that correct?

A It's—

Q If Mr. Gordon said—

A To answer your question, it is an area in which we exercise a considerable amount of judgment based on our past experience with the individual staff members and Subcommittees and, in past experience, we generally do.

Q Well, let me ask, then, the relevant question. I apologize for asking a philosophical one.

Is it your experience or is it your judgment that what Mr. Gordon tells you about Senator Nelson's views and what Dr. Horowitz tells you about Senator Kennedy's views provides an accurate basis for you to conclude what the views are of those two Senators?

A In experience, Dr. Horowitz' assertions with respect to what Senator Kennedy's position would be are fairly articulate. I would never suggest that all of the desires and expressions of interest on the part of Ben Gordon reflect the desires and interests of Senator Nelson.

* * *

[Page 115, line 13 of Deposition]

Q Was it your position, then, Mr. Ahart, that the interests the GAO was attempting to pursue would be better served by a

cooperative study than would be served by exercising access to records rights?

A It was my judgment at that time, and still is, as I have responded to one of your earlier questions, that it would be more valuable to do a study with the cooperation of industry. With access to more data in terms of over a longer period of time, it would be possible, in looking at data relating to individual contracts, that that would be more valuable in terms of serving the public interest than would be a somewhat narrower approach possible under access to records pertinent to individual contracts.

Q But we are still talking about a survey with the same objective. Namely, to find out the pricing practices or economics of the pharmaceutical industry, is that correct?

A That is correct bu the approach under the individual contract access to records route would be a somewhat more modest study than would be the broader study with the cooperation of industry.

Q You have used that phrase "a more modest study" several times, I believe, in your Affidavit in Support of the Government's Motion for Summary Judgment as well as in your Answers to Interrogatories.

Could you explain what you mean by "a more modest study" under the access to records clause?

A Well, under the access to records clause, you have a responsibility, on the part of the supplier, to make available records pertinent to the contract transactions for the period of three years after the final payment.

Obviously, that places constraints on the amount of time you can look at it. What we had in mind, with the cooperation of industry, was a broader study looking at the operations of the sample companies over time and, particularly, the cycling of products in and out of the companies' available products, going through the research and all through the marketing and so on, which is more difficult to do if you are limited to looking at records only for three years after final payment.

Q So it is your understanding that one limitation on the study that you are now attempting to pursue is that the time period of the directly pertinent records would be limited?

A That is correct.

Q To a three-year period?

A That is correct.

Q And, also, the records would be only those pertinent to the specific contracts involved in the assertion of the access to records clause?

A It would be those documents which are directly pertinent to the—I wouldn't want to get involved in the precise wording of the clause, at this point. I would have to refer to it.

But the documents encompassed in the purview of the access to records clause, yes.

Q Let me ask if, in your judgment, you believed then—that is, in the summer of 1974—that, if you were able to give the six drug companies an assurance that individual company data would not be further disclosed publicly, that the companies would have cooperated in the Phase II study that you had designed?

A It was my perception, based on discussions with representatives of industry and representatives of individual firms, that, if we could offer an ironclad or gold plated or 100 percent guarantee, that there was a good chance that their management would choose to cooperate with us in this study.

Q And you explained that to the staffs of the two Subcommittee?

A That is correct.

Q And they were not pursuaded, I take it, to allow you to give such a commitment?

A As I said, they expressed their view that the office should not bind itself to an absolute guarantee of nondisclosure.

Q And, as a result, we are where we are today, that you are trying to pursue a much narrower study than the one that you would have felt was more meaningful, is that true?

A That is a more modest study than the one I would rather have had us pursue.

Q Can you think of any other impediment that would have blocked your ability to conduct the Phase II study other than your inability to give a confidentiality commitment?

A Well, I felt, at the time, it was my judgment that was the main block.

Q Were there any others?

A I have no way of knowing, with any degree of certainty, how the mangement of those companies would have come out even if we had been able to offer the ironclad guarantee.

Q But, as far as you know and as far as you knew at the time, this was the only concern that had been expressed by the companies involved about participating in your study?

A To the best of my recollection, this was the primary concern. I can't recall any others specifically.

Q Could you refer to Exhibit PA-30? This is a memorandum from Mr. Keller to Mr. Staats. Mr. Keller was, at that time, the Deputy Comptroller General, is that correct?

A That is correct.

Q The memorandum, as you will see, is one that appears to have been sent to you. Do you recall receiving it?

A I was furnished a copy of this memorandum, yes. I initialed it, so I assume I saw it.

Q Would you direct your attention, please, to—well, strike that. Would you read over the three options that are reviewed here by Mr. Keller for the Comptroller General?

A Uh-huh.

Q Directing your attention specifically to paragraph two of this memorandum, it states that one of the options is to give the companies a written commitment as to confidentiality of individual company costs and profits.

Mr. Keller, however, says he warns against doing so without some agreement with Senator Kennedy and Senator

Nelson and he states that you agree with that position. Was that your position at the time?

A That is correct.

Q It further suggests, in the concluding paragraph, that you and Mr. Keller and Mr. Dembling agree that it would be appropriate for Mr. Staats to meet with Senator Kennedy and Senator Nelson to discuss the alternatives.

A That is correct.

Q That was your agreement?

A That is correct.

Q Did such a meeting take place?

A As I was saying earlier, there were meetings held with both Senator Kennedy and Senator Nelson in August of 1974 to discuss the matter with them and I don't recollect whether we told them, at that time, whether we were going to proceed with a formal demand letter but we did make it clear to them that, without the pledge of confidentiality, we felt we were at an impasse with the drug companies in getting further cooperation and that this was the logical alternative.

Q Who was present at those meetings?

A At the meeting with Senator Kennedy, I was present with Mr. Staats, and Dr. Horowitz was present. At the meeting with Senator Nelson, Mr. Staats was accompanied by Mr. Crowther and I assume Mr. Gordon was at the meeting but I am not sure of that.

Q Do you know whether the position of the General Accounting Office was explained at those meetings to Senator Kennedy and Senator Nelson, namely, as I understand it, that it was your judgment that a cooperative study was the kind of study you wanted to conduct?

A At the meeting with Senator Kennedy, I could testify to the fact that it was explained.

Q Is it your understanding that the same point was made at the meeting with Senator Nelson?

A It certainly was.

Q And neither Senator Kennedy nor Senator Nelson, as Mr. Keller put it, agreed to giving a written commitment of confidentiality to the companies, is that correct?

A Well, in Senator Kennedy's case, it was his position it would be inappropriate for the General Accounting Office to compromise any rights that the Congress might have to place demands on us for information if it so chose. He didn't feel that the office was in a position to give away rights which he felt the Congress had.

Q Did he make it clear to you, on that occasion or on any other occasion, that he wanted to obtain access to cost information regarding individual products?

A My best recollection at that meeting is he did not indicate whether he did or did not. He did make a point that he did not want to be foreclosed of what he felt was a prerogative of the Subcommittee by unilateral action on the part of the Comptroller General.

MR. EDGAR: Could I have that answer read back?

(Whereupon, the previous answer was read back by the Court Reporter.)

BY MR. LACOVARA:

Q Can we move to Exhibit PA-32 for one second. This is a letter from Senator Kennedy to the Comptroller General in February, 1975, after the law suit was filed.

A Yes, I have that document before me.

Q The second paragraph has Senator Kennedy asking Mr. Staats, "Do you think you will be able to get the kind of information we talked about?"

Do you know what information it was that Mr. Staats and Senator Kennedy talked about?

A I don't know the specific intent of the Senator in this particular reference.

Q Did Mr. Staats—excuse me.

A We talked about the gaining of access to the company records.

Q Specifically cost records?

A Cost and pricing records, the information relating thereto, and I would take this—and I think I did at the time—as being a general reference to that kind of information.

Q Was it your understanding, at the time, that Senator Kennedy was primarily interested in the cost data from individual companies?

A In the context of this letter, yes.

Q I would like, now, to change our focus. Specifically, I would like you to refer to Exhibit PA-1, again. Those are your Answers to Interrogatories, and I ask you to read over your answer to Interrogatory 8, in which you set forth the purposes of the request for access set forth in the Comptroller General's August 26, 1974, letter.

A I have read the answer.

Q Would you explain to me, please, what you meant when you stated that the purpose of the study is to determine "the adequacy of the protection afforded the Government by the negotiation techniques used by the procuring agencies"?

A Yes. Basically, that refers to the fact that in many of the cases involving the procurement of drugs the techniques are basically centered on a comparison of the offered price, with the standard catalogue price published by the manufacturer, and on prior prices paid by the Government for the same product and that is, basically, all the information that is in the hands of the Contracting Officer and all that he is really required to have in hand under the basic procurement statutes by virtue of the catalogue price exception to the Truth in Negotiation Act.

The reference, here, to the adequacy of protection afforded the Government by the negotiation techniques used by the procuring agencies is in the context of the way the companies do business, the way they price their products, what it costs them to make the products, does the negotiation technique afford the Government adequate protection.

Q In the context of the explanation you have just given, can you suggest what you would be looking for in this review to

determine whether or not existing procurement procedures are adequate?

A We would want an understanding of how the prices which were either placed in the catalogue, if that was the final price, or the prices which were paid by the Federal Government, based on the offer by the manufacturer, were arrived at. What were the considerations that went into arriving at those prices. What relationship, if any, these prices had to such costs as might be assigned to the individual contract or to the production and making available, publicly, the individual products involved.

Q Don't you already have the answers to those questions on the basis of Phase I?

A No, I don't have the answers to those questions on the basis of Phase I. All I have on the basis of Phase I, as I indicated before, is a very skeletal explanation, verbal for the most part, by representatives of the individual drug firms as to some of the broad considerations that they take into account in establishing catalogue prices.

* * *

[Page 131, line 8 of Deposition]

Q Is it a purpose of this study that you are proposing to perform to determine the reasonableness of the prices set in each of the four contracts at issue?

A It is purpose not to determine the reasonableness of prices, per se, for contracts but to determine the reasonableness of the way the companies go about establishing their prices and whether or not the factors that go into the establishment of those prices are relevant to the Government part of that contractor's business.

Q Could you elaborate on that for me?

A Well, I could probably give quite a dissertation on it and I don't know how much time you would like to take.

Q Oh, about one paragraph.

A One paragraph, all right. It is represented that the drug industry does not price based solely on cost considerations,

at least, and it has been asserted that cost is really not a factor in their pricing methodology but, rather, they look at the market place. Basically, what is the competition for a proposed new product they are going to consider for marketing and consider what that product should be worth in the market place and that their pricing considerations look more at the company overall that what contributions the various products will make as opposed to trying to recover, trying to equate or relate specifically, the cost of producing product with the price it should bear on the market place.

They have some losers and they have some winners and you cannot look at manufacturing costs, for example, on a particular drug product and relate it to the price asked for that product and make any reasonable judgment as to the reasonableness of the price. It has to be looked at in a larger context.

It is this kind of consideration and this kind of thinking which led us to the conclusion that the broader study would be more valuable than to go in and look and try to reach our judgment on these considerations on an individual contract basis.

Q Well, let me see if I can understand, then, what your objective is.

You want, first, to ascertain whether that is the way prices are set for the four contracts at issue, is that true?

A We want to ascertain how the prices were established for individual contracts and what considerations were taken into account.

Q And if you assume that they were set the way you have describe the representations stated that they were set, you will determine whether that is a reasonable way of setting prices?

A We will make some judgment from the standpoint of the Federal procurement posture as to whether the—again, without knowing the specific information on individual firms, what will come out. It is difficult to speculate, but we will try to reach a judgment, given the way drug companies do or perhaps have to do business, on whether the Government is getting,

with the procurement techniques and negotiation techniques now used—whether or not it is being afforded adequate protection and public interest under the present methodology.

* * *

[Page 135, line 1 of Deposition]

Q Would you look at costs which the manufacturers do not consider in setting prices?

A If they affect the prices paid by the Government, yes, we would.

Q Could you explain to me how they would affect the prices if they are not considered in the pricing decision?

A Well, as I indicated earlier at least as being represented to us, you almost have to look at the overall business to understand the considerations taken into account in the establishment of prices.

Overall, the companies, I'm sure, establish prices for their full range of products which they expect will result in a profit and, somehow or other, this requires that, in total, the sales dollar, in orders by the Government or other parties, must cover all of the costs of the going concern as well as to produce a profit.

So the prices paid by Government do contribute to, in some measure, the total costs of operating the business and furnishing a return on the capital.

Q Let me see if I have this one. I think what you are saying is that, it is the purpose of the GAO study that you would like to do in the exercise of alleged access to records authority to ascertain not only what costs a company incurs, that it explicitly considers in pricing one of the four products sold to the Government, but also all other costs that the company incurs, even though it does not explicitly consider those costs in setting price to the Government, is that correct?

A Well, I think that what we want to look at can best be explained by reference to the statute which is the authority, and I would be glad to look it up and state it, but it is those books,

records, et cetera, which are pertinent to the performance of the contract—the contract and its performance. I would be glad to get the specific language.

Q Well, I am really trying to understand what has never been clear to me and I dare say may be important to make it clear to the court.

How far beyond the specific direct costs to manufacturing the four products that were sold to the Government in this contract does the GAO assert a right to examine?

A Well, again, our assertion of the right to examine is consistent with the language in the statute.

Q Well, that is the ultimate issue but let me ask it this way:

Is it your position that you have the right to examine costs that are not allocated by the company to the manufacture of the products that were sold to the Government under these four contracts?

A If they are pertinent to the performance of the contracts, yes.

Q What does that mean to you—"pertinent to the performance of the contracts"?

A Well, let me state it, perhaps, in a negative sense. I don't think the accident of whether a company for management purposes uses its accounting system to allocate costs for specific products is germane to whether the costs are pertinent to the furnishing of those products under the contract to the Government.

Q What other costs would be pertinent?

A Well, I assume that each company is trying to recover, as I have stated before, on an overall business basis, the total cost of doing business, which would include the research and development costs which the company feels it must incur to stay in business.

It would be incurring marketing costs which the company feels it must incur to place its products in the market place and in the hands of the ultimate user.

It would certainly include the direct manufacturing costs of the product; the distribution costs; some portion, I would assume, of the overall corporate, general and administrative expenses is probably attributable to doing each contract.

Q You have listed what I think is an exhaustive and all-inclusive listing of all costs any company, including a drug company, can incur in doing business.

A Well, I find myself, handicapped on responding to your question by virtue of the fact that we have not been permitted access to the accounting systems, to the information relating specifically to pricing considerations taken into account in establishing prices, the only thing we have available to us, with respect to the firms, is verbal assertions to us by company officials as to what they do, in very general and vague terms.

I currently find myself in a position where I can't be very specific on exactly what we would need access to or what is directly pertinent to the contracts in the context and within the purview of the statutory rights of access.

Q Sure. We have been talking, I thought, on an assumption that certain costs experienced by the company were not considered explicitly by the company in setting a price for a particular product—that is, in an accounting sense, they are not allocated to the cost of producing that product.

My question to you is, is it the position of the General Accounting Office that records of costs that are not considered in setting the prices of products sold to the Government are directly pertinent to the contracts because they are costs which are, in a sense, financed by the revenues obtained by the company under a Government contract?

A This would be my judgment. Again, going back, I don't believe the management's choice, as to what costs ought to be allocated to individual products should be included in accounting records, would control which costs are pertinent to the performance of a contract.

For example, if they did not account for drug manufacturing costs, I don't think that makes manufacturing costs any

less pertinent to the performance under the contract with the Government.

Q Are there any costs that the company incurs which you would consider not pertinent to the contracts that are at issue in this litigation?

A Well, I think that is the other end of the same question. Since I am not in a position to describe, specifically, those costs which are pertinent because of lack of knowledge, I am in the same position with respect to being able to state, specifically, which costs would not be pertinent.

Q All right. Let me see if I understand where we have gotten in this dialogue.

The GAO claims the right to determine what costs are pertinent and will not accept the representations of management, is that fair, so far?

A Would not what?

Q Accept the representations of management about what costs are pertinent.

A Well, I think, certainly, we have a responsibility to reach our own determination, based on knowledge, as to what in our judgment is pertinent.

Q And that knowledge—

A To individual contracts.

Q And that knowledge would be gained by reviewing the records themselves?

A I have no way that I can reach this judgment without more knowledge than we have now as to what is or is not pertinent to the performance under individual contracts.

Q Well, as you can tell, from my groping questions, I am trying to determine whether there is anything, that we can agree on today, that is outside of your right to access as you understand it in this litigation.

A Well, I think that I could agree that if you have a firm that is engaged in two lines of business, one of which is

pharmaceutical products and one of which is something else, and if, in the accounting system, through reasonable allocation process, the one part of the business or, at least, some part of the costs can be judged to relate solely to the non-pharmaceutical line of business, that certainly I would exclude that from being within the purview or pertaining directly to the pharmaceutical supply contract.

Q Okay. But in a company like Merck which, let us assume, has a separate division that manufacturers pharmaceuticals, it would be your position that Merck had a single Government contract, which included an access to records clause, gives the General Accounting Office the legal authority to review all of the records in the company relating to costs for the General Accounting Office to ascertain the extent to which, if at all, those costs are pertinent to the specific contract, is that correct?

MR. EDGAR: Hold on.

THE WITNESS: I didn't say that.

BY MR. LACOVARA:

Q No. I recognize that you didn't put it in those words but I am trying to see what I thought was a reformulation of your testimony. I may have gone wrong.

MR. EDGAR: I think you started out with an assumption and put in about eight different modifiers and came up with the wrong conclusion.

You started out with a hypothetical division and then you branched into all costs of the company.

BY MR. LACOVARA:

Q Excuse me. If I modified my hypothetical—

A I had enough trouble with the hypothetical and, with your statement, I am afraid I am going to have trouble with your modification.

Q The hypothetical is this: Merck and company has a division which manufactures pharmaceuticals. Let's call it the

Merck, Sharp and Dome Division, for want of a better name, since that happens to be its name.

Let's assume that it has a single Government contract under which it supplies a product called "Aldomet" to the Government. Is it the General Accounting Office's position that, under the access to records clause, in that "Aldomet" contract, the GAO has the right to examine all of the records of the Merck, Sharp & Dome Division to determine the extent to which, if at all, those costs affect the price of "Aldomet" in that contract?

A The answer to your question is, no.

Q What records would not be subject to the review, in your understanding?

A Your hypothetical posed one Government contract for one product in a manufacturing division of Merck. To the extent that we could look at the accounting system and satisfy ourselves that, under the accounting system, manufacturing costs for other products were correctly segregated from the cost of manufacturing this product, we would not require access to the manufacturing costs of all the other products.

Q And if manufacturing costs are not segregated and applied exclusively to other products, then your answer is to the contrary, namely, that you would assert the right to examine those, let us call them, records of unallocated costs?

A To the extent that it would be necessary for us to identify costs which are directly pertinent to performance under the contract, yes.

Q Well, we are back to "directly pertinent," again. How direct does "directly pertinent" have to be in order to come within your claim of right? Can you give me some feel for that?

A Well, in answer to the Interrogatory that we are talking about here, one test is whether or not these affect the prices paid by the Government.

Q Even though the company may not have taken them into account in establishing a price?

A Even though the company may not have taken them specifically into account in establishing a price.

Q The fact that they are there as a general ambient of the company's business is enough to make them directly pertinent to the performance of the contract?

A In my judgment, that would be.

Q And this is true even if a company only has one Government contract?

A Since the access to records clause is brought to bear on an individual contract basis, yes.

* * *

[Page 150, line 18 of Deposition]

Q In that same response—that is, Response 13(a)—and, specifically, Subpharagraph (3), where you state that you are also interested in records relating to the methodology and decisions involved in Plaintiff's establishment of prices for the products purchased, do I, at least this time, understand your position correctly in understanding that to mean that you are not claiming a right to examine documents relating to the methodology or decisions establishing the prices of other products under the access to records clause?

A That would be correct.

Q So we can at least agree on that, that the pricing documents are those concerned exclusively with the four products that are the subject of the contracts?

A Yes.

Q I was beginning to think that I didn't understand anything about this case, which is really my problem and not yours.

Could you refer to Exhibit PA-36 for one moment, please?

A Yes, I have that document before me.

Q Have you seen this document before?

A Yes. I would have seen this document in the ordinary course of business.

Q Directing your attention to Paragraph 3 on page 2, the memorandum purports to quote your position on your exercise of access to records rights.

A This is Paragraph 3?

Q Paragraph 3 on page 2.

A Yes.

Q As far as you can tell, does it accurately reflect your position?

A Yes.

Q And it states that you expressed concern that use of access to records rights would involve a change in the study specifically related to the time period for which records could be obtained.

A It does not state that I expressed concern. It stated that I recognized that some changes would, of necessity, have to be made in that approach.

Q But you are unable, today, to give me any idea what the limitations on the time periods would be, is that correct?

A Yes, that is correct. The constraints are as I stated but without more specific knowledge than we possess, we can't be more specific.

Q So even if costs were not considered in pricing a particular product, conceivably you would insist on the right to records that might be 20 years old or might relate to costs incurred 20 years ago?

A If they were determined to be directly pertinent to the contract.

Q But we have no way of deciding how they might be directly pertinent. There is no way you can define how you would make that test.

A If they affect the prices, if they are given consideration during the pricing of the—

Q No, they are not given consideration by the company in making its pricing decision.

A If they are not given specific consideration, we would have to make a judgment as to whether or not, irrespective of specific consideration, they affect the prices.

Q In the sense that you described before, that they relate to the company's overall costs and, sooner or later, the company wants to make a profit on a company-wide or division-wide basis?

A Yes.

Q Are you trying to determine, in this study, what the products in question should have cost the Government?

A No, we are not trying to determine what the products should have cost the Government. As I stated previously, we are trying to determine whether the procurement techniques that are now being used, with respect to pharmaceutical products, afford adequate protection to the Government in the public interest.

Q But you are concerned with what the products did, in fact, cost the manufacturer, to the extent you can ascertain that?

A This would be of concern to us, yes.

Q And one of the things that you would be trying to determine, as I understand it, is whether the prices actually paid are higher than those that should have been paid or could have been paid under a different system, is that accurate?

A Well, again, I think I would stick to the statement that we are trying to assess the adequacy of the protection afforded the Government in the present procurement system.

To do that, we have to have an understanding of how the company does business and what costs—what relationship costs have to prices paid, what other considerations are taken into account in the establishment of prices, the business reasons for taking these considerations into account, and get that kind of an understanding before we can make a judgment on whether the present procurement process and techniques do afford adequate protection to the Government.

Q Protection against whom?

A It would be protection in the sense that, under the circumstances, you would have assurance that the overall procurement system and the techniques that are used in relationship to the way the industry does business, the prices are reasonable.

Q "Reasonable" meaning what?

A Well, this is a judgmental matter.

Q It is the key, isn't it?

A It is key. My personal view is that, if a company's representations to us about how they go about doing business, you probably have to make this judgment on a broader base than the individual products.

Q And you are getting hard pressed to make that judgment on the basis of examining four contracts?

A Yes. You would be hard pressed to make that judgment on the basis of examining four contracts but, as indicated in one of the documents that you just referenced, we would attempt to reach that judgment by looking at four contracts and then, perhaps, more contracts until we had as good an understanding as we feel we need to reach a judgment.

Q What other contracts?

A Well, these are a selection of contracts out of one fiscal year. I would presume that, so long as the companies stay in business and that those products are needed by the Government, there will be other contracts.

Q Are you suggesting that you have decided to make further access to records requests for other fiscal years?

A I am suggesting that we are going to try to fulfill what we deem to be our responsibility in this area and I think we will—if we can't do it on the basis of four then, I guess, there would be additional reviews in the pharmaceutical arena to help us reach that understanding.

Q Of the same companies?

A Perhaps it could be of the same companies— additional ones of the same companies—and perhaps additional companies.

Q Have you made that decision, yet?

A I am in the box of not having—not knowing what I don't know and I am not in a position to make a judgment

other than we will do our best to fulfill what we perceive to be our responsibilities.

Q We could be living together for a long time, then, couldn't we?

A I would expect that, if the pharmaceutical industry is taken as a whole, there will be some period of time involved.

Q There is a study underway—

A We have already lived together for some time.

Q Happily, I am glad to say. There is a study already underway at Roche, is that correct?

A That is correct.

Q Can you tell us how long that study has been underway?

A We have been on site at Roche since on or about June 30th, 1975, with some relatively brief periods of absence to accommodate Roche.

Q And how long do you expect that study to continue?

A I don't have any present judgment that I would want to stand behind. It will probably be a matter of several more months.

Q And that study is an outgrowth of the study we have been discussing today?

A This is an outgrowth of the same efforts we undertook to gain an understanding of the pharmaceutical industry and make some judgments on the adequacy of the procurement processes.

Q Under the access to records clause, as you understand it, do you claim the right to examine Merck's records of indirect costs and cost controls, for example?

A I will have to answer the question the same way. To the extent that they are pertinent to the contracts, the subject contracts, yes.

Q And you would claim, I gather, on the basis of your earlier testimony, that you have the right to examine Merck's accounting system and cost estimating systems?

A We would have to have an understanding of those systems to reach a reasonable judgment on what records are pertinent.

Q And Merck's purchasing and subcontracting procedures?

A Again, to the extent that the judgment was they were pertinent. I'm sorry I can't be more specific.

Q But you would have to look at the records to decide whether they were pertinent or not, is that correct?

A Yes.

Q You would have to understand the system to reach a judgment as to whether they were pertinent or not.

A We don't have to look at every individual cost record to reach that judgment.

Q Surely. You claim the right to examine internal management studies in the reviews?

A Again, to the extent that they were pertinent. A management study, for example of what price would be placed on the product procured by the Government would seem to be to be pertinent to the contract.

Q Any management studies that you can think of beyond evaluations of the price to be charged for the particular products covered by the contract?

A I am not in a position to speculate as to what kinds of management studies may have been made.

Q How about management studies about other products?

A That are not subject to the individual contract?

Q Other than the four products governed by these contracts.

A My judgment would be, if they related solely to another product, in the same vein as I talked about manufacturing costs and pricing documentation, that they would not be accessible under the access to records clause.

Q How about budgetary information—budgetary system?

A Again, I will have to resort to the same general answer. I don't know the budgetary systems of the companies in question.

Q So you would have to look at them to see whether you could understand them and then determine how far you would want to go?

A We would have to have some knowledge of the budgetary system to see to what extent those are pertinent in the transactions in question.

Q I think you have answered this one, but I would like to make it clear. How about transactions that are not explicitly related to the specific contract containing the access to records clause?

A Could you define the term "explicit" for me?

Q That is that does not state this event is taking place in connection with Contract Number so-and-so for the provision of a product to the Government.

A Well, I think you are right that we have already answered that. I think we would be interested in the substance of the relationship and not the documentation which may or may not explicitly relate the two.

Q Do you claim the right to examine any of Merck's records of sales to non-Government customers?

A I guess we would be interested in examining that to the extent of satisfying ourselves, for example, of the validity of the contractor's determination in that a particular product was subject to substantial sales to the private sector, bringing it within the exception of the Truth in Negotiation clause.

[Exhibit PA 10 to Ahart Deposition]

U.S. General Accounting Office
Manpower and Welfare Division

A PROPOSED APPROACH TO PHASE II OF GAO'S STUDY OF FEDERAL PROCUREMENT OF PHARMACEUTICALS

MARCH 1974

A PROPOSED APPROACH TO PHASE II OF GAO'S STUDY OF FEDERAL PROCUREMENT OF PHARMACEUTICALS

INTRODUCTION

Federal expenditures for prescription drugs are large and increasing annually. In fiscal year 1973, direct Federal expenditures and reimbursements for prescription drugs amounted to about $1.6 billion—an increase of more than $44 million over expenditures in fiscal year 1972 and more than $500 million over fiscal year 1970 expenditures. This amount includes about $252 million in direct drug purchases by Federal agencies and reimbursements of over $1.3 billion under federally sponsored health programs such as Medicare and Medicaid. (Note: Estimates for reimbursement programs include costs of drug dispensing.)

Under its legislative mandate and authority for evaluating Federal programs and activities, the General Accounting Office has studied drug procurement from the standpoint of the Federal agencies that buy and reimburse for drugs. Without complete access to necessary industry data, we have, to date, been unable to develop and acceptable approach to the study of Federal drug procurement from the viewpoint of the suppliers of pharmaceutical products.

Accordingly, in October 1973, we launched the first phase of a two-phase approach to this study. The first-phase—which

consisted of visits to the facilities of six drug manufacturers—was designed to obtain an education about the drug manufacturing industry and its related practices and to enable us to develop an intelligent approach to Phase II of the study. Following is a summary of information obtained during Phase I of our study of the activities of the pharmaceutical industry and our proposal for Phase II.

SUMMARY OF INFORMATION OBTAINED AND OBSERVATIONS MADE DURING PHASE I OF OUR STUDY

Phase I of our effort provided us with considerable insight into (1) the nature of the industry, (2) the extent to which costs are assigned, either directly or through cost allocation mechanisms, to individual products, and (3) some of the obstacles to allocating full costs to individual products among therapeutic classes of products, or between Government and non-Government business. To a lesser degree, we have gained insight into the extent to and manner in which costs are considered in marketing and pricing decisions and into the way in which other factors, including competition, influence these decisions.

I. INDUSTRY CHARACTERISTICS

1. The drug industry is composed of a relatively large number of firms, but is highly dominated by a relatively few large companies. The six firms we visited represented some of the largest and most profitable firms in the industry. All six firms were members of the Pharmaceutical Manufacturers Association (PMA) which is comprised of over 100 member companies.

2. The drug industry is highly profitable judged on the basis of return on net worth or return on sales. One study showed that in 1972, return on net worth was 21.4 percent for drug companies compared to 10.7 percent for all manufacturing and return on sales was 12.9 percent for drug companies compared to 4.3 percent for all manufacturing.

3. Industry products experience relatively rapid obsolescence and emphasis is placed on developing a continual flow of new products.

4. There appears to be a large amount of inter-industry sales of both bulk chemicals and finished dosage forms.

5. Some firms in the industry offer a full line of pharmaceutical products which encompass many therapeutic classes and many products within each class, whereas other firms tend to specialize in specific therapeutic classes of products. In this connection, the "full line" companies might sell some of their products at relatively low margins or, in some cases, below cost, while this situation may not be as prevalent with companies dealing with more specialized lines of products.

II. COST ACCOUNTING

Although there was some variation in the cost accounting systems among the six firms, we found that there is also a substantial amount of similarity among their systems. Below is discussed some of our impressions:

1. All six drug companies used a standard costing methodology to value inventory and cost of goods sold. Variations between standard and actual costs are generally expensed as period costs.

2. Under the cost accounting systems, the extent to which costs are applied to products is limited essentially to manufacturing costs. However, the types of costs included in manufacturing costs and allocated to products vary from firm to firm.

3. Generally, overhead costs such as depreciation, building costs and administrative costs are not allocated to products but rather are allocated only partially to departmental levels.

4. Some costs—such as R&D, marketing and certain corporate overhead costs—are not allocated even to the firms' pharmaceutical lines of business.

5. Special analyses—such as potential product profitability analyses—are occasionally developed to aid in making certain management decisions. However, there is little continuity among firms concerning the types of

analyses done and the methodologies employed to do them.

6. Research and development costs are treated as period costs and are expensed against income. Application of R&D costs and quantification of the role of R&D is a particularly important factor in our review because of its magnitude and strategic importance in pricing and marketing. One study showed that for six major drug firms (four of which were included in Phase I), R&D costs may approximate 150 percent of total investment in plant and equipment.

7. In general, the cost accounting systems emphasize responsibility accounting rather than accounting for product costing.

8. Indirect overhead costs, such as factory services, are generally allocated to departments or manufacturing centers by use of standard cost rates. Although these costs are allocated to departments or centers, frequently they are not included in inventory valuation.

III. PRICING AND COMPETITION

In the area of pricing and competition, one fact stands out and that is that the extent of price competition varies greatly among products. For some products, price appears to be relatively sensitive to the price of some other products, but for other products, the company appears to be able to set the price rather arbitrarily. The following overall impressions were gained from our company visits regarding price and competition.

1. It is necessary to precisely define what constitutes the competition for a specific product. Generally, effective competition appears to exist almost exclusively within a therapeutic class, e.g., tranquilizers, and sometimes effective competition is limited to pharmacological classes within a therapeutic class, e.g., skeletal muscle relaxants or barbiturates within the tranquilizer class.

2. Products with a high degree of patent protection and for which few substitutable products exist generally

experience little price competition. Conversely, sales of non-patented products may demonstrate significant price sensitivity.

3. Competition, particularly price competition, appears to be increasing in the industry due to the expiration of patents, the declining number of significantly differentiated new products being marketed, and the increasing number of generic products being marketed by both large and small firms.

4. Cross-licensing of patented products among two or more firms is quite common—particularly among major firms.

5. The two basic price-setting techniques are: (1) negotiated and competitive bid pricing, and (2) pricing to the market.

6. Negotiated and competitive bid pricing is used primarily in sales to the Government and other large institutional buyers.

7. Pricing to the market involves consideration of the cost of alternative therapy—in the form of alternate drug products or alternate medical regimens. The price of alternative therapy appears to establish a range of feasible prices. The following additional considerations also appear to be involved in making price determinations.

A. Product related factors:

(1) Dosage forms

(2) Expected product life

(3) Acute or chronic disease use

B. Market related factors:

(1) Anticipated size of market

(2) New or established market

(3) Permanent or temporary market (vaccines)

(4) To whom product is marketed

(5) Competitive prices and the uniqueness of the product

(6) Cost per day of therapy

(7) Amount of promotion that competitive products are receiving

C. Cost related factors

(1) Roughly estimated research costs

(2) Royalties and licensing fees

(3) Required capital investment

(4) Estimated promotional costs

(5) Assessment of sales returns and allowances

(6) Product shelf-life

8. At most of the companies visited prices were established in the marketing department or by special committees and approved by top management.

9. Direct-sale prices to the Federal Government are among the lowest prices charged, but they may not, in all cases, be the lowest prices charged. For some products, some companies do, in effect, use incremental pricing for Government business and do not cover all indirect overhead costs in the Government price.

IV. RESEARCH AND DEVELOPMENT

Research and development (R&D) activities are a major component of industry operations and have a strong effect on marketing strategy, price levels, profitability, and investment in manufacturing resources. Three aspects of R&D, taken together, provide a concise general description of R&D activities. They are (1) the division of research between product and non-product (basic) research, (2) specialization of research into a few therapeutic areas, and (3) the productivity of research. Our impressions regarding these factors and others follow:

(1) All companies we visited perform a great deal of research into the discovery of products having specific characteristics to meet established market requirements. In this connection, several firms orient their R&D activities

toward the molecular modification of existing major products. In addition, some of the companies perform a substantial amount of basic research in which the development of a specific marketable product is not a prime objective.

(2) Generally, firms tended to specialize their research activities by concentrating them in a few major therapeutic areas.

(3) The productivity of R&D activities appears to be declining because much of the industry's R&D does not result in profitable products. Discovery of highly unique and significant new drugs is rare. Furthermore, stringent requirements of product safety and efficacy have increased the commercial risks of new product introductions.

(4) Drug companies maintain large and well-equipped biomedical research facilities, including large and highly trained professional research staffs.

(5) Generally, quality control testing laboratories are separate from research laboratories.

V. MARKETING AND PROMOTION

Marketing includes determining the number and type of products a firm offers as well as the target consumer group and promotional strategy that is used. In drug companies, research and development activities are also a prominent component of the firms' marketing strategy. The ideal marketing strategy is to market primarily highly unique and patented new products that are effective for frequently occurring medical problems. Currently, however, several companies are modifying this strategy and are aggressively developing broad generic product lines while continuing research into unique, high demand products. Other information obtained was as follows:

1. Products derived from molecular modifications of existing products generally must compete with closely similar products, but are marketed and promoted as new products. Because of the predominance of price leadership

characteristics for these kinds of products, the price of a new product is generally about the same as that of its close competitors and emphasis is placed on promotion and advertising to create product distinction and demand.

2. The same drug is frequently marketed in a large number of different dosage forms and package sizes. The firms appear to emphasize unique dosage forms where the active ingredient is not particularly unique.

3. The use of easily-remembered and highly-advertised brand names is used to create product distinction with physicians.

4. In general, each firm has a marketing department composed of group product managers responsible for developing marketing plans, objectives, and sales programs, and establishing prices. Organizational components of marketing departments include—in addition to product managers—marketing staff services such as advertising, market research, planning, product design, and the field sales forces.

5. In the drug industry, field sales personnel are professional representatives (detailmen) who promote and furnish information about company products to physicians. The field sales force varied from about 400 to about 900 at the six companies we visited.

6. Several companies have recently formed new marketing organizations to distribute products under distinct labels. Apparently, the purpose of these new marketing organizations is to increase the size of the detailing staff and also to more closely match up products with specialized detailmen promoting to a distinct category of physicians, e.g., pediatricians.

7. Generally, detailmen only promote to those physicians who are most likely to prescribe and use their products. Consequently, introduction of new product in a therapeutic area not previously germane to a company's products may require substantial technical retraining and increases in the detailing force.

8. Detailing is also carried on in hospitals and institutions because of the influence of pharmacy and therapeutic committees on the institutional procurement of products.

9. In a very general sense, most drug companies specialize in a few therapeutic categories. The firms concentrate both their research and development activity and their marketing and promotional activity in a relatively few therapeutic classes. However, in view of the current emphasis on the marketing of generics by traditionally "brand-name" firms, this rather narrow marketing strategy may be obsolescent.

10. Traditionally, drug companies have provided free samples to physicians as a form of advertising.

VI. MANUFACTURING

Pharmaceutical manufacturing consists of the production of active drug ingredients and the production of finished dosage forms. Production of the active drug ingredient may involve antibiotic fermentation, plant or animal extraction processes or synthetic chemical manufacture. Synthetic chemical manufacturing is the most frequently used process of manufacturing with antibiotic fermentation second in volume. Frequently, firms try to synthetically manufacture drugs that were previously obtained by extraction processes.

An extensive quality assurance process is a major component of drug manufacturing.

The scope of the total manufacturing process is frequently difficult to ascertain because of the large amount of sales between companies and transfers between divisions within a company. Total drug manufacturing encompasses all the changes created from the combination of simple chemical ingredients until the finished forms are furnished to the patient. For simplicity, we have excluded the final prescription preparation step in the pharmacy and the initial preparation of chemical precursors or antibiotic feedstock from the manufacturing sequence. Even with such exclusions, however, the

changes created at any one pharmaceutical firm may be only a small part of the total production process necessary to furnish a drug product.

The following general impressions of the manufacturing operations were obtained during our visits:

1. Frequently, bulk chemical production is conducted in a distinct corporate division and the output is transferred to a pharmaceuticals or laboratories division for preparation of finished dosage forms, packaging, and distribution.

2. Most manufacturing operations are carried out in fixed batch sizes rather than in a continuous process. Generally, the size of the batch represents the most efficient and productive size within the constraints of plant capacity. When particularly large orders are received, multiple batches are made but the batch size is not changed.

3. Although most production operations are relatively level year-round, antibiotic production experiences significant seasonal variation.

4. Quality assurance operations may employ about 5 percent of a company's total workforce. We were told that production at one firm included 676 separate quality control tests. Generally, quality assurance tests are performed at fixed points along the various production sequences.

VII. REGULATION

The drug industry is subject to rather extensive Federal regulation and control. At the Federal level, the Food and Drug Administration (FDA) establishes standards for both manufacturing and products, and promulgates many requirements that affect research activities. Other Federal agencies impact on the drug industry by setting formal and informal requirements dealing with product packaging, employee safety, environmental control and dangerous drug control. Still other requirements include Securities and Exchange Reports, Federal Trade Commission statistical reports, various antitrust require-

ments, and routine Internal Revenue Service reports. General impressions obtained during our six visits regarding regulatory impact on the industry were as follows:

1. FDA requirements for proof of the efficacy and safety of new drug products has reduced the number of new product introductions and has significantly increased the cost and commercial risks of new product introductions. It appears that some companies have transferred research and clinical testing abroad because of the stringency of FDA requirements.

2. FDA labeling requirements have reduced the number of clinical indications that can be claimed for a new product and thus has reduced the ultimate consumer demand and expected total sales of new products.

3. FDA labeling requirements and prohibitions on promotional claims has restricted the extent to which detailmen have been able to create product demand. We were given several examples of products that could not be marketed profitably because of limitations on promotional claims.

4. Many of the companies have installed elaborate pollution control systems in response to environmental control regulations.

5. FDA's Good Manufacturing Practices (GMP's) requirements generally require more costly capital investment than other regulatory requirements affecting production.

6. Antitrust considerations has had a significant impact on the operations of some firms.

7. Several companies emphasized the new capital investment necessary to comply with employee safety requirements.

8. Generally, dangerous drug control requirements appear to act more to decrease the efficiency of physical distribution than to increase capital investment requirements, although some additional facilities are necessary.

OBJECTIVE OF PHASE II OF THE STUDY

In presenting our proposal for the two-phase approach to this effort, we stated our belief that a GAO study of the activities of the drug industry would be beneficial in our attempts to determine whether the Government should consider alternatives to its present policies and practices related to Federal drug procurements. We believe that—as a result of our visits to the six firms included in Phase I—a continuing GAO effort to secure a better and somewhat less abstract understanding of the internal economics of the industry should enhance our ability to achieve this objective.

In addition, based on the information conveyed to us during Phase I, we believe that the results of a comprehensive and objective GAO study of the economics and operations of the drug industry would be particularly beneficial in providing needed information to the Congress and to the Federal agencies responsible for procuring and reimbursing for prescription drugs. An objective GAO presentation concerning salient economic and operational aspects of the industry could also be of significant benefit to the industry itself which, for some time, has encountered rather strained relationships with certain Federal agencies, congressional committees and the public. Accordingly, our objective under Phase II of this effort is to gather and develop the data necessary to make such a presentation to the Congress and to those Federal agencies responsible for various aspects of drug procurement and reimbursement activities.

* * *

[Exhibit PA 16 to Ahart Deposition]

UNITED STATES GOVERNMENT

Memorandum

GENERAL ACCOUNTING OFFICE
FOR CONGRESSIONAL CONTACT FILE
Monopoly Subcommittee, Select
Committee on Small Business,
U.S. Senate

TO: OLL

FROM: Assistant Director, DD—C.S. Collins

SUBJECT: Access to cost records of drug companies

On September 14, 1971, Mr. Dean Crowther and I visited Mr. Ben Gordon, Staff Economist to the Monopoly Subcommittee, Select Committee on Small Business, U.S. Senate, to discuss the draft of the proposed letter from Senator Nelson to the General Accounting Office which we arranged to prepare at an earlier meeting (see the final paragraph of the Congressional Contact File memorandum dated August 13, 1971.) Action on the proposed letter had been deferred due to Mr. Gordon's illness. Today, September 14, 1971 was Mr. Gordon's first day back in his office following hospitalization.

After reading the proposed memorandum Mr. Gordon said that he felt that the information we planned to furnish did not get to the heart of the problem of the sale of drugs, as he envisioned it. Mr. Gordon indicated that he would like to obtain information which would indicate the costs and profits made by individual drug firms on sales of individual drug items and cited Thorazine, sold by Smith, Kline, & French (SKF), which he said accounts for a very large portion of this firm's profits.

This particular situation was discussed at length in the earlier meeting of August 9 when we pointed out that the drug

firms would refuse access to their cost records if to the data identified costs with specific drugs and drug companies. We pointed out to Mr. Gordon that the overall summary data which we proposed to supply could probably be furnished by therapeutic categories and that this might be sufficient to meet his objectives, i.e. to disclose generally high rates of profits in the industry and as a basis for the possible regulation of prices by the Government. We also pointed out that indirect costs are abnormally high in the drug industry, the case of SKF, and that an equitable allocation of these costs, to arrive at the cost of individual drugs, would be difficult and probably controversial.

Mr. Gordon pointed out that our proposal did not include furnishing information on the cost of imported raw materials. He cited the case of Thorazine which he said is sold by a Canadian licensee to the Canadian Government for about $2 a unit compared with over $30 a unit by the American licensee to the U.S. Government. He said that the raw material for the item is imported from France and that very little effort and costs are involved in converting the raw material into the furnished product sold in the United States and Canada.

Mr. Gordon said that he would have to consider carefully and discuss with his associates the letter we had proposed for Senator Nelson's signature. He said that he expected to do this within the next few days and that he would call Mr. Crowther after he had arrived at a position. During our conversation Mr. Gordon said that he felt that the General Accounting Office had the right to review manufacturers' cost data and that if they refused access to the data the Government should press for the information, through the courts if necessary.

[Exhibit PA 17 to Ahart Deposition]

UNITED STATES GOVERNMENT

Memorandum

GENERAL ACCOUNTING OFFICE
FOR CONGRESSIONAL CONTACT FILE
Select Committee on Small
Business and Monopoly

TO: OLL

FROM: Associate Director, CD—Dean K. Crowther

SUBJECT: Telephone Conversation with Mr. Ben Gordon, Staff Economist, Select Committee on Small Business and Monopoly

I telephoned Mr. Gordon to inquire about the status of the draft request we had prepared and previously discussed with Senator Nelson and Mr. Gordon, that would request a review of selected drug manufacturing companies sales and cost records relating to Federal procurement of pharmaceuticals. Mr. Gordon expressed his view that rather than attempt to obtain such cost records under an arrangement that would preclude reporting of manufacturing firm names or identifying individual drug items, he would prefer to press for obtaining such records without any strings attached so that the high profits could be publicized by product and firm. Mr. Gordon mentioned that he had discussed this matter with several of his colleagues, who are also economists, and he said they supported his view as the only way that might have an affect of reducing drug prices.

Mr. Gordon said he had made his views known to Senator Nelson and he asked the Senator for a decision on our proposed letter. The Senator wanted to discuss the matter with some of his advisors before finally deciding.

Mr. Gordon believes so strongly in the open publicity approach as being the way to solve the problem of high drug

prices that he would be willing to sacrifice the time required to obtain the manufacturers cost records through the courts.

I explained that a decision is needed in order for us to continue our fieldwork because of the refusal of the manufacturing firms to furnish their cost records to us thus far. Mr. Gordon said he would try to get back to Senator Nelson Friday or Monday, October 15 or 18 and he would keep us advised.

[Exhibit PA 18 to Ahart Deposition]

EXAMINATION OF THE PROCUREMENT OF DRUGS BY NATIONAL AGENCIES

PROBLEM OF ACCESS TO COST ACCOUNTING RECORDS OF DRUG COMPANIES

Resume

1. In January 1971 during hearings before the Subcommittee on Small Business and Monopoly, Senate Select Committee on Small Business, chaired by Senator Gaylord Nelson, it was brought out that GAO had the right to examine contractor cost records under negotiated contracts (to determine contractor costs) and Senator Nelson exhorted us to exercise this authority. No requests other than the verbal suggestion during the hearings and reiterated in subsequent meetings with Senator and his assistant, Mr. Ben Gordon, have been made. No written request has been received.

2. For many months, Mr. Gordon, who has been aware that we have been continuing our review of Federal drug procurement activities, has been stating that the Comptroller General will be requested to testify at a new round of hearings on drugs—originally planned for the fall of 1971, but now planned for early in 1972. Because of the strong possibility of our being questioned on the review of contractor records, reviews were initiated at four drug companies—Smith, Kline & French (SKF), Eli Lilly, Lederle Laboratories, and Wyeth Inc.

3. Lederle Laboratories have actually refused our New York staff access to pertinent cost records. While Smith, Kline & French have not specifically refused us access to its cost records, its actions can be construed as tantamount to refusal. Eli Lilly has not specifically refused access but it has advised our Cincinnati staff that the cost records are considered "confidential" and have requested to be advised why we require them. We have left the question unanswered pending the

possibility of working out an arrangement agreeable to both Smith, Kline & French and Senator Nelson, which, if successful, could be used in dealings with the three other drug companies. Wyeth had also informed our staff that its cost records will not be made available to us. Currently, work is stalled at SKF, Lederle, and Lilly and our regional staffs are making ready to pull out from the plants. Generally good cooperation has been given by the drug companies on information we have requested, short of cost data and, in one case, pricing policies, and the data we have developed will be useful.

4. In our last contact with Mr. Gordon, see Congressional Contact Memo of Mr. Crowther dated October 18, 1971 (copy attached), Mr. Gordon stated that both he and Senator Nelson feel that we should press our right of access to the cost records—through the courts if necessary—with a view to using the data in any way we see fit, and more particularly in any way the Small Business Subcommittee wishes to have the information. It has been made clear in discussions with Mr. Gordon, that the subcommittee will want cost information on specific drug items and specific drug companies. We believe that the possible use of cost data in this matter is a primary reason for the reluctance of the drug companies to give us access to their cost data.

5. In view of the conflicting positions of Senator Nelson and the drug companies and the extent of our involvement it appears from a long-range Office viewpoint that there is no viable alternative than to press the companies for access to their cost data. Accordingly, we suggest sending letters along the lines of the attached draft to SKF (others would be adapted where necessary) to elicit a written yes or no decision from the companies. Should a negative answer be given, this would presumably be turned over to the Office of General Counsel for consideration of legal action.

[Exhibit PA 19 to Ahart Deposition]

UNITED STATES GOVERNMENT

Memorandum

GENERAL ACCOUNTING OFFICE
FOR CONGRESSIONAL CONTACT FILE
Select Committee on Small Business
and Monopoly
United States Senate

TO: OLL October 18, 1971

FROM: Associate Director, CD—Dean K. Crowther

SUBJECT: Telephone call from Mr. Ben Gordon, Staff Economist, Select Committee on Small Business and Monopoly

Mr. Gordon telephoned late Friday, October 15, 1971 and advised that he had talked with Senator Nelson about our proposed request to obtain cost records of manufacturers selling pharmaceuticals to the Federal Government. Mr. Gordon said the Senator agreed that we should obtain the cost records without any strings attached so that the information could be used as needed. Mr. Gordon also said that the Senator would like for us to proceed on our own authority without a written request from the Committee.

On the other hand, he also said that the Committee intends to hold another round of hearings in January 1972 and have each agency come back that had previously testified including GAO. The Committee would like to make public, during such hearings, any problems we may be having in obtaining drug manufacturers cost information. Mr. Gordon would like to be kept apprised of our progress.

[Exhibit PA 27 to Ahart Deposition]

UNITED STATES GOVERNMENT

Memorandum

GENERAL ACCOUNTING OFFICE
FOR CONGRESSIONAL CONTACT FILE
Subcommittee on Health, Senate
Committee on Labor and Public Welfare
Subcommittee on Monopoly, Senate
Committee on Small Business

TO: OCR April 29, 1974

FROM: Audit Manager, MWD—David P. Baine

SUBJECT: Meeting with Subcommittee Staff Members Concerning Our Proposed Review of the Economics and Operations of the Drug Industry (code 10133)

On Friday, April 26, 1974, Mr. Dean Crowther, Deputy Director, MWD, Mr. James Galloway, Supervisory Auditor, MWD, and I met with the following members of the Subcommittee staffs:

Dr. Larry Horowitz, Subcommittee on Health
Mr. Walter Sheridan, Subcommittee on Health
Ms. Jessica Silver, Counsel, Subcommittee on Health
Mr. Ben Gordon, Subcommittee on Monopoly

The purpose of the meeting was to (1) describe, in general terms, our proposed efforts to evaluate the economics and operations of the drug industry and their impact on the Federal procurement and reimbursement programs for prescription drugs and (2) to emphasize the need for us to maintain—both during and after the study—anonymity with regard to specific company and product data which we hope to collect during the study.

Mr. Crowther briefly described our activities under Phase I of the study and outlined our proposed approach to Phase II.

He stated that we had gone to significant lengths to elicit a degree of cooperation from the industry which has—heretofore—not been forthcoming. He stated also that, as a result of Phase I of the effort, we had gained considerable insight into the operations of the industry and have developed what, we believe, is a sound and practicable approach to an objective review which will make a contribution to the Congress and to the agencies involved in drug procurement and reimbursement activities. He stated further that in order to successfully complete our effort as proposed, and particularly since we will be asking the drug firms for access to far more data than we could demand under our statutory authority, we believe we must be in a position to assure the participating firms that the information we develop will, insofar as it relates to individual companies and to individual drug products, necessarily have to remain confidential and anonymous both for the purposes of our report and thereafter.

The staff members stated their collective opinion that the proposed study as Mr. Crowther had described it, would not serve the purposes of their respective Subcommittees. They stated further that they believe the only way the Subcommittees' objectives would be served and drug prices to the Government and to the public would be reduced will be to gather and publicize specific price and cost data for individual products—particularly those for which competition is limited and price mark-ups are high.

The staff members present inquired concerning why the Office has not exercised its access to records authority to obtain cost information concerning individual drug products purchased under negotiated contracts. Mr. Gordon pointed out that the Monopoly Subcommittee had been inquiring into this area for over 2 years.

Mr. Crowther replied that we believed—for several reasons—that a GAO effort to conduct a review on a cooperative basis with the industry would be more beneficial to the needs of the Congress and involved agencies than would a review conducted as a result of access to records obtained through exercising our authority under individually negotiated contracts.

We cited as primary reasons, the distinct prospect for a long period of litigation and, more importantly, the fact that the information obtained on a cooperative basis would in our opinion, far exceed that which we might obtain following such litigation.

The staff members maintained their position concerning their need for product-specific data and requested that we provide them a written summary of our posposed review approach in order that they may study it further and discuss the matter with their Subcommittee chairmen before commenting further on our proposed efforts. Mr. Crowther agreed to provide them a paper concerning our proposed efforts as soon as possible.

[Exhibit PA 32 to Ahart Deposition]

UNITED STATES SENATE
Committee On
Labor and Public Welfare
Washington, D.C. 20510

February 11, 1975

B-146857
Mr. Elmer B. Staats
Comptroller General
of the United States
Washington, D.C. 20548

Dear Mr. Staats:

I would very much appreciate an update on your progress in gaining access to cost information involving negotiated Federal procurement of drugs.

What is the status of the Merck and Company suit? Have the other companies cooperated? Do you think you will be able to get the kind of information we talked about?

I would very much appreciate it if your staff would keep Dr. Lawrence Horowitz of my staff fully informed as this process continues.

My very best wishes.

Sincerely,

/s/ EDWARD M. KENNEDY

Edward M. Kennedy, *Chairman*
Senate Health Subcommittee

[Exhibit PA 36 to Ahart Deposition]

UNITED STATES GOVERNMENT

Memorandum

GENERAL ACCOUNTING OFFICE

TO: Assistant Director, MWD—
Thomas P. McCormick

FROM: Supervisory Auditor, MWD—David P. Baine

SUBJECT: Visit to Bristol Laboratories to Follow-up on Bristol's Response to the Comptroller General's August 26, 1974, Letter Requesting Access to Bristol's Records Under Specified Contracts (Code 10133)

On October 29, 1974, Messrs. Ahart, J. Martin and I met with the following officials of Bristol Laboratories to discuss Bristol's response to the Comptroller General's August 26, 1974, letter requesting access to records under the terms of specified Bristol contracts.

Douglas R. Purdy, Vice President—Administration, Bristol Laboratories

Robert Endries, Legal Counsel, Bristol Laboratories

Erwin M. Stern, Assistant Controller, Bristol Laboratories

Larry W. Zonner, Manager, Cost Accounting, Bristol Laboratories

Joseph Loudin, Controller, Bristol-Myers Industrial Division, Syracuse Plant

Mr. Purdy began the meeting by explaining some organizational changes which have taken place at Bristol's Syracuse

plant since our visit to the plant in December 1973. He stated that a new group designated as the "Industrial Division" was formed in January 1974. This group has assumed some of the functions formerly carried out by the Bristol Laboratories' organization in Syracuse—principally those relating to bulk manufacturing. The Industrial Division also has responsibility for the manufacturing operations of other Bristol-Myers subsidiaries such as Mead-Johnson. Mr. Purdy stated that the headquarters for the Industrial Division is in Syracuse and that the division reports to the parent corporation through the International Division.

Mr. Purdy stated that his organization continues to provide administrative support for that portion of the Syracuse plant now assigned to the Industrial Division, as well as for the rest of the Bristol Laboratories operations in Syracuse, which are now essentially related to drug finishing operations.

Mr. Purdy stated that Bristol Laboratories was not inclined at the present time to become involved in legal proceedings regarding our right of access to drug firm information under specified Federal contracts. He said the company was, however, concerned about the scope of the work we intended to do at the firm, and particularly about the amount and types of records we felt compelled to request to carry out that work.

Mr. Ahart stated that it is our belief that an approach similar to the one we proposed to the drug firms in April 1974—which would involve voluntary cooperation by the firms involved—continues to be the most appropriate method by which we can carry out our legislative reporting responsibility to the Congress. In this regard, he stated that we continue to believe that a comprehensive report concerning the economics of the drug industry and the contribution to gross margins made by groupings of products might have a significant impact on several pending legislative proposals in the health area which, in turn, could have an effect on the activities of the industry.

In this regard Mr. Ahart stated that if we were to use our right of access under specified Federal contracts, we would attempt, insofar as possible, to present a report similar to that

which we had proposed to present under the April 1974 proposal. He recognized that some changes would, of necessity, have to be made in that approach—particularly those changes related to (1) the time periods for which records could be obtained and (2) the firms' products which could be included in the study. He emphasized, however, that if we were to achieve access to company records under our access to records authority, we would be obligated to make as an extensive review as possible of firms' operations in order that we could achieve a proper balance in any report we might issue as a result of such a study.

Mr. Purdy stated neither he nor the other Bristol officials had anticipated that GAO was prepared to continue its work on the basis of the April 1974 proposal. After a brief period during which Bristol officials reviewed the proposal, Mr. Purdy stated that he believed Bristol would have some basic problems with certain parts of that proposal, particularly as it related to the time periods to be covered and the categorization of products into competitive classes.

A fairly lengthy discussion ensued concerning specific aspects of the April 1974 proposal. During the discussion, Mr. Ahart emphasized the need for product groupings to be developed along the lines of their market considerations and their ability to contribute to gross margins, rather than along other lines such as therapeutic classes.

Throughout the meeting Messrs. Purdy and Endries emphasized Bristol's concerns regarding the need to safeguard the confidentiality of the firm's data needed by GAO for such a study. While emphasizing that our need to verify data supplied by firms' would require that detailed working papers be maintained by GAO, Mr. Ahart reiterated our position on the matter of confidentiality—both as it relates to the content of our proposed report and the supporting material. Mr. Ahart suggested that a meeting involving the Comptroller General or himself with top Bristol officials might be helpful to alleviate some of Bristol's concerns regarding the confidentiality issue.

At the conclusion of the meeting, Mr. Purdy stated that Bristol would like to respond in greater detail to our Office

concerning its position on the April 1974, proposal. Mr. Ahart stated that we would appreciate Bristol's comments on the proposal. However, he also emphasized that because of the length of time which has passed since the Comptroller General's August 24, 1974 letter, we were not in a position to experience further significant delays in our review activities—whether they be pursued under our formal right of access to contractor's records or under the procedures involving firm's cooperation.

Mr. Purdy stated that we could expect to receive Bristol's detailed comments concerning the April 1974 proposal within 10 days to 2 weeks.

[Exhibit PA 42 to Ahart Deposition]

September 8, 1970

TO: Mr. Charles M. Bailey
Director, Defense Division

FROM: Mr. Paul G. Dembling
General Counsel

SUBJECT: Reply to memorandum dated August 17, 1970, requesting opinion regarding GAO's legal authority for performing "should cost" reviews—(Code No. 81831)-B-159896-O.M.

A "should cost" review as defined in your memorandum would involve an attempt to determine the amount that weapons systems or products ought to cost, given attainable efficiency and economy of operations. Such reviews would not only utilize all the current concepts employed in evaluating price proposals but also would include development and consideration of possible areas for attaining additional economy and efficiency in the procurement of a product or service. You advise that in order to complete a successful "should cost" review it is essential that there be not only the normal availability of a contractor's pertinent books and records on a specific contract but also complete and timely access to his (1) budgetary and management information systems, (2) middle and top management personnel, and (3) manufacturing facilities. You request a legal opinion as to GAO's authority to perform Comprehensive "should cost" reviews, which require the type of data discussed above, at a Government contractor's facility. In this connection, you report that there has been some Congressional interest in having GAO perform "should cost" reviews, while contractors generally appear to be of the opinion that GAO's standard access-to-records authority does not include access to the contractor's personnel or to his plant.

The standard access-to-records clause provides that GAO shall have the right to examine any directly pertinent books,

documents, papers, and records of the contractor involving transactions related to the contract in question. ASPR 7-104-15. This clause is required by statute to be included in most negotiated contracts made by the Government in excess of $2500. 10 U.S.C. 2313(B); 41 U.S.C. 254(c). In the case of *United States* v. *Hewlett-Packard Company*, 385 Fed 1013 (1967), cert. denied 390 U.S. 988 (1968), the court held that the clause and statute gave GAO the right to examine the contractor's costs of performing the contract even though production costs were not considered in negotiating the contract price. The court said that the production costs involved transactions relating to the contract because they encompassed business arrangements made by the contractor in obtaining the materials, labor, facilities and the like required by it in fulfilling its commitment with reference to the subject matter of the contract.

So far, *Hewlett-Packard* is the only case ruling on GAO's access-to-records authority. The limits of GAO's authority to examine records under this statute are yet to be defined by the courts. Obviously there are limits. The statute restricts GAO to those books and records which are directly pertinent to and which involve transactions relating to the specific contract being reviewed. Books and records which are not directly pertinent or which concern transactions not relating to the specific contract need not be made available to GAO for examination. In our opinion a "should cost" review to determine what a particular product ought to cost would call for access to certain information which would be beyond the scope of GAO's access authority. For example, we doubt whether a contractor's budgetary data would normally come within the scope of the statute and contract clause, although such information would be significant for a "should cost" study.

Furthermore, a "should cost" review would require access to and discussions with a contractor's management personnel and to his manufacturing facilities. However, our statute does not provide such access. It only provides for access to books, documents, papers and records. We think a contractor could rightfully refuse to provide GAO with access to its personnel or plant for the purpose of conducting a "should cost" review.

Accordingly, we must advise that in our opinion GAO does not have a firm statutory basis to perform comprehensive "should cost" audits.

[Exhibit PA 43 to Ahart Deposition]

B 159896 (.07) October 22, 1970

TO: General Counsel

FROM: Director, DD—C.M. Bailey

SUBJECT: Draft legislation expanding GAO's authority to perform "should cost" type reviews

In your decision, B-159896-O.M., dated September 8, 1970, you advised us that GAO apparently lacks firm statutory authority to perform comprehensive reviews of contractors' operations ("should cost" reviews). In our forthcoming report to the Congress, we intend to point this fact out and to suggest that the Congress may wish to consider expanding our authority in this area.

We believe it would be desirable for us to be prepared when the report is issued to the Congress, about January 31, 1971, with draft legislation that can be considered by appropriate committees. In our opinion, the proposed legislation should provide, as a minimum that:

1. Any contractor holding negotiated contracts valued at $100,000 or more will be subject to review.

2. GAO will have the right to examine into all aspects of operations and management, including but not limited to:

   a. production systems and controls
   b. plant design
   c. labor standards
   d. quality control systems
   e. equipment utilization
   f. indirect costs and control
   g. accounting and cost estimating systems
   h. purchasing and subcontracting procedures
   i. internal management studies and reviews

3. GAO's rights shall not be limited to documents and records pertinent to particular contracts, but should be

broadly interpreted to permit access to all documents, records, personnel, and other data considered necessary to evaluate the efficiency and economy of the contractors' operations.

It would appear to be desirable for these rights to be incorporated into applicable Government contracts and the legislation could, therefore, be drafted so as to amend or replace the current contractual provisions for GAO access to contractors' records.

We would appreciate your drafting legislation to accomplish the objectives described above. Mr. Jerome H. Stolarow, Assistant Director of this Division, is responsible for our "should cost" review efforts and will be available to assist you if further information is needed.

[Exhibit PA 50 to Ahart Deposition]

B-162009-O.M. August 31, 1967

Director, Civil Division

Returned. The July 10, 1967, memorandum from Gregory J. Ahart, Deputy Director, Civil Division, requests advice regarding the right of General Accounting Office representatives to audit a Government contractor's sales records to ascertain if in fact the contractor sold substantial quantities of particular catalog items to the general public, thereby qualifying for a permissive exemption from the mandatory cost and pricing data submission and certification requirements imposed on negotiated procurements by 10 U.S.C. 2306(f), Public Law 87-653, the "Truth in Negotiation Act of 1962." In particular, you are interested in examining the manufacturer's sales records which pertain to the catalog sales exemption granted Electronic Associates, Inc. (EAI) of West Long Branch, New Jersey, by the cognizant contracting personnel at Marshall Space Flight Center, National Aeronautics and Space Administration (NASA) incident to the award of contracts number HAS8-15103 of June 30, 1965; HAS8-16789 of November 11, 1965; HAS8-17425 of February 10, 1966; and HAS8-17438 of May 6, 1966, for the purchase of electronic computers and associated equipment.

The letters attached to the July 10, 1967, memorandum show that procurement personnel at Marshall Space Flight Center, before award of the first above mentioned contract, unsuccessfully attempted to obtain detailed sales data for the particular items being procured, in order to independently determine whether the items actually had been sold in large quantities to nongovernment users. In the absence of more comprehensive sales data, the contracting officer was forced to rely upon an overall figure which simply segregated total yearly sales to the Government for all EAI products from total sales to nongovernmental customers and determined on this basis that because EAI had made substantial sales to the public, the contracts could be exempted from the cost certification requirements incident to negotiated procurements.

Under 10 U.S.C. 2313(b) the gist of which was included as paragraph 10(a) of the standard provision of the contracts in question, presumably on Standard Form 32 (Supply Contract), June 1964 edition, representatives of this Office are entitled to:

> "*** examine any books, documents, papers, or records of the contractor, or any of his subcontractors, that directly pertain to, and involve transactions relating to the contract or subcontract."

Commercial sales records do not pertain to or involve transactions relating to government contracts, and we have no right of access thereto under 10 U.S.C. 2313(b).

As to the propriety of the action of NASA contracting personnel in permitting contracts to be negotiated solely on the basis of catalog prices without any showing of substantial sales of the item to the public, it appears that the NASA contracting personnel have violated the criterion established by paragraph 3-807-1(a) of the NASA Procurement Regulation, that catalog price purchases require:

> "*** positive demonstration by convincing evidence to support the application of this exception. It is not enough that an item be listed in a catalog or price list, or be offered for sale to the general public, or be intended to become a commercial item, but tangible and substantial sales activity must be shown to result from such listing, offering, or intention. *** "

We interpret this regulation as applying on an item by item basis.

R.F. KELLER

Acting Comptroller General
of the United States

Attachment

[Exhibit PA 54 to Ahart Deposition]

B-141683-O.M. June 5, 1968

TO: Mr. Edward Friedman, Procurement, Defense Division

FROM: Mr. Stephen P. Haycock, Assistant General Counsel

Your memorandum of May 9, 1968, raises a question concerning the authority of GAO to review contractors' records with respect to both Government and commercial work under the Defense Production Act, 1950. You state that in connection with a survey Defense Division has accumulated some evidence that contractors are in violation of the priorities system contemplated by the Defense Production Act, 1950, and the Business and Defense Services Administration (EDSA) regulations implementing it. The precise question involved is whether GAO has a right to review contractors' commercial records with respect to production scheduling and shipments of material either under the Examination of Records Clause (Clause 10 of Standard Form 32) or under the authority granted the EDSA under the Defense Production Act, 1950. We understand that Defense Division is interested only incidentally, if at all, in cost and pricing data for the negotiated contracts that may be involved.

In regard to GAO's right of access to records under the Defense Production Act it would appear that no provision of the Act itself grants GAO the right to examine a contractor's commercial records relating to production scheduling, shipments of material or the like. On the contrary, it appears that certain provisions of the Defense Production Act and other legislation militate against any such conclusion. See 50 U.S.C. App. 2155(e) and 2162(c). See also Executive Order 20480, August 14, 1953, set out as a note under 50 U.S.C. App. 2153 and the analysis set forth in a memorandum date April 21, 1960 (B-141683), by Mr. Masterson to Mr. Ramsey.

With respect to the Examination of Records Clause set forth in Standard Form 32 which apparently is incorporated in

the negotiated contracts involved, it would appear that the types of records sought cannot reasonably be considered as "directly pertinent * * * records of the Contractor involving transactions related to this contract" (Underscoring supplied [sic]. In B-16209-O.M., August 31, 1967, the Director, Civil Division, was advised that GAO did not have a right of access to a manufacturer's sales records which pertain to the catalog sales exception granted to a contractor pursuant to the "Truth in Negotiation Act of 1962". The present records sought are even more removed from the coverage of Clause 10 of S.F. 32 than were the sales records involved in B-162009-O.M. See, also, B-158349-O.M., April 13, 1966, where it was observed that Fairchild Camera's refusal to provide statistical information relating to the overall financial activities of its Space and Defense Systems Division (which was performing only Federal contracts) was not necessarily contrary to law and that nothing in the law requires a contractor to furnish GAO with listings of its Government contracts or their degree of completion. *A fortiori* it must be concluded that nothing in the law requires a contractor to furnish GAO with records relating to production scheduling and shipments of materials in its commercial business.

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

MERCK & CO., INC.
Plaintiff,

v.

ELMER B. STAATS, Comptroller General
of the United States,
Defendant,

and

THE UNITED STATES OF AMERICA,
Intervenor-Defendant.

STATEMENT OF PLAINTIFF, MERCK & CO., INC. PURSUANT TO LOCAL RULE 1-9(h)

* * *

[Page 16 of Rule 1-9(h) Statement]

DEVELOPMENTS CULMINATING IN THE COMPTROLLER GENERAL'S DEMAND FOR ACCESS TO MERCK'S RECORDS

31. GAO's demand for access to cost and pricing records of pharmaceutical companies originated with a suggestion by Senator Gaylord Nelson in January, 1971. By letter of December 23, 1970, Senator Nelson, Chairman of the Monopoly Subcommittee of the Senate Select Committee on Small Business, requested that, as part of his testimony at upcoming subcommittee hearings on the status of competition in the pharmaceutical industry, the Comptroller General report on any efforts by the GAO to examine records of contractors supplying drugs to the government. (Ahart Dep., Exhibit PA-13, p. 2). During the hearings, Senator Nelson inquired into

GAO's authority to obtain cost records from government contracts. Upon being informed that GAO believed it had such authority under a 1951 statute but had never sought to invoke that authority to obtain drug company data, Senator Nelson urged the Comptroller General to utilize the statute to examine cost records:

> "I realized it may be a very complicated matter, but it would seem to me that all companies ought to be served notice that the GAO is going to utilize this statute. I think that we ought to take a look at some of those costs. *Hearings on Competitive Problems in the Drug Industry Before the Subcommittee on Monopoly of the Senate Select Committee on Small Business,* 92d Cong., 1st Sess., 8020 (1971).

32. The subcommittee scheduled additional hearings for the fall of 1971 and informed the Comptroller General that he would be required to testify at those hearings. Because of "the strong possibility of our being questioned on review of contractor records," GAO issued record review requests to four pharmaceutical companies. (Ahart Dep., Exhibit PA-18, p. 1).

33. Although the hearings were rescheduled for the spring of 1972, Senator Nelson and his staff continued to press GAO for action regarding drug company cost records in a series of conversations with Comptroller General Staats and GAO personnel during the latter half of 1971. (Ahart Dep., Exhibits PA-14, PA-15, PA-16, PA-17, PA-18, PA-19, PA-20, PA-21, PA-22). At a meeting on August 9, 1971, the Comptroller General asked Senator Nelson and his staff economist, Ben Gordon, what purpose would be served by obtaining cost data identified to specific products and individual companies and whether their objectives could be realized if only group data were obtained. Gordon indicated a strong preference for individual product and company data and stated that "such data should be made public." (Ahart Dep., Exhibit PA-15). During subsequent discussions with GAO personnel, Gordon reiterated his desire to secure individual product cost data for specific firms in order to publicize high cost items. Despite

GAO's view that an equitable allocation of indirect costs would be difficult to make for individual products, Gordon urged GAO to exercise its right to examine individual product cost data and to "press for the information, through the courts, if necessary." (Ahart Dep., Exhibits PA-16,PA-17). After conferring with Senator Nelson, Gordon advised GAO officials that the Senator agreed that GAO should endeavor to secure individual product cost data "without any strings attached so that the information could be used as needed." (Ahart Dep., Exhibit Pa-19).

34. Following these discussions, GAO concluded that, "[i]n view of the conflicting positions of Senator Nelson and the drug companies, . . . there is no viable alternative than to press the companies for access to their cost data." (Ahart Dep., Exhibit PA-18).

35. By letter dated January 18, 1972, Comptroller General Staats informed Senator Nelson that GAO believed that it would not be feasible to develop cost figures for particular types of drugs because of the impossibility of identifying comparable drugs and the fact that particular drugs would not be representative of the drug industry. (Ahart Dep., Exhibit PA-23).

36. On May 10, 1972, the Comptroller General again appeared before Senator Nelson's subcommittee. (See *Hearings on Competitive Problems in the Drug Industry Before the Subcommittee on Small Business*, 92d Cong., 2d Sess. (1972)). During the hearings, Senator Nelson questioned the Comptroller General about GAO's attempts to obtain "production costs respecting drugs" from pharmaceutical manufacturers. (*Hearings, supra,* at 8573). The Comptroller General responded that GAO did not think that pursuing company cost records for individual drug items "was the most productive way to get at reduction of costs to the Government." (*Hearings, supra,* at 8579). He explained that it was unlikely that the Government was paying unreasonable prices for drugs:

> "You have to recognize that again, the Government here is a very small customer, a very small customer—in most cases, less than 3 percent, or

> certainly less than 5 percent. So the companies are concerned with the commercial market. This is not without some protection to the Government. If they have to meet their competition in the commercial market, which represents 95 percent of the business, and the Government gets a discount from any other published price, it is a little hard on the face of it to say that the Government is not getting good prices." *Hearings, supra,* at 8580-81.

The Comptroller General also questioned whether meaningful conclusions could be drawn on an individual drug item basis and stated his preference for an industry-wide study "of total sales to the Government on negotiated contracts." (*Hearings, supra,* 8577).

37. Senator Nelson showed dissatisfaction with the position taken by the Comptroller General:

> SENATOR NELSON. Well, my question is do you intend to implement the statute which authorizes you to look at cost production figures on negotiated contracts respecting drugs or not? My understanding from my conversations and our hearings and your letters to me is that in fact, you were going to proceed and that when you got started, the company said, no, we "ain't" going to show you anything.
>
> What did they refuse to show you, then?
>
> MR. STAATS. You have the transcript there. I do not recall that we ever said we were going to proceed. I think we said we were considering what we could get here.
>
> * * * *
>
> MR. STAATS. I am well aware, Mr. Chairman, that you would like us to take these cases into court. I think that is what you are asking that we do. (*Hearings supra,* at 8581).

38. In late 1972, GAO approached the Pharmaceutical Manufacturers Association (PMA), an organization composed

of over one hundred companies engaged in the manufacture of pharmaceuticals, in an attempt to obtain the voluntary participation of its member firms in a study of the economics of the pharmaceutical industry. (Roy Aff. ¶ 4). By letter dated December 13, 1972, PMA informed the GAO that the proposed study was unacceptable because of problems regarding the feasibility of developing product cost and investment data and concerns that the confidential information provided to GAO would become public. (Roy Aff. ¶ 4 & Exhibit A).

39. In March, 1973, GAO considered a number of approaches to conducting a study of the drug industry. The agency noted that several of the options had the disadvantage that "[c]ongressional committees concerned with unit costs would not be satisfied." GAO also concluded that options focusing on individual drug items might not yield results "representative of the industry" and might produce "misleading" data. The options involving drug company costs presented GAO with the problems of allocating indirect costs to particular products. (Ahart Dep., Exhibit PA-9).

40. GAO decided to proceed with the voluntary cooperation of the drug companies and again approached PMA regarding a study of the economics of the drug industry. Following discussion with several member firm representatives, GAO in June, 1973 proposed a revised study to be conducted in two phases. In "Phase I", GAO would send staff personnel to several companies to observe manufacturing, research and related activities and to become acquainted with relevant accounting practices. Based on knowledge gained during Phase I, GAO proposed to design a broadbased study of the economics of the pharmaceutical industry to be carried out in "Phase II." (Roy Aff. ¶ 5 & Exhibit B). Merck and five other pharmaceutical companies (Eli Lilly and Company, Abbott Laboratories, SmithKline & French Laboratories, Bristol Laboratories, and Hoffman-La Roche Inc.) volunteered to participate in Phase I on the understanding that access to detailed cost records pertaining to specific products would not be granted. During November 1973, GAO personnel visited and inspected Merck's facilities and operations at Rahway, New Jersey, and

West Point, Pennsylvania and consulted at length with Merck representatives. (Roy Aff. ¶ 5).

41. GAO issued its report on Phase I and its proposal for Phase II on or about April 17, 1974. The proposal stated that the objective of the Phase II study was "to gather and develop the data necessary" to make a presentation "concerning salient economic and operational aspects of the industry." Matters to be covered included, among others, considerations governing product pricing, overall profitability, research and development, manufacturing, marketing, distribution, and corporate overhead activities. The proposal indicated that GAO would require data for the year 1964 through 1973 for each firm covering: (1) sales volume, (2) manufacturing costs, (3) research and development expenses, (4) general and administrative expenses, (5) marketing expenses, (6) distribution expenses, (7) other expenses related to the firm's pharmaceutical business, and (8) capital investment. (Roy Aff. ¶ 6; Ahart Dep., Exhibit PA-10).

42. Comments on the report were submitted by PMA and by several participating member firms, including Merck. By letter of June 6, 1974, Merck expressed reservations about participating in aspects of the proposed Phase II study requiring disclosure of confidential information, including individual product cost and pricing data, in view of GAO's inability to assure Merck that the material would be maintained on a confidential basis. (Roy Aff. ¶ 6 & Exhibit D).

43. GAO considered it feasible to pursue Phase II of the study on the basis of assurances to volunteering companies that no data about individual companies or individual products would be released. GAO believed that if it gave such assurances, the volunteering companies, including Merck would have participated in Phase II. (Ahart Dep., pp. 40-41, 118-19 & Exhibits PA-26, PA-27, PA-30).

44. GAO, in 1974, informed the subcommittee staffs that it could obtain "far more data" through a voluntary approach "than we could demand under our statutory authority." (Ahart Dep., p. 107 & Exhibits PA-27, PA-29). GAO believed then,

and still believes, that a study based on voluntary cooperation of the drug companies could be more valuable than a study based on data obtained through access to records demands. (Ahart Dep., p. 115 & Exhibit PA-27).

45. The sole reason GAO decided not to proceed with Phase II as a satisfactory, voluntary study was that two senators and their staff assistants objected to GAO's giving the companies, including Merck, any assurances that individual product data would be kept confidential. (Ahart Dep., pp. 118-19 & Exhibits PA-27, PA-29, PA-30).

46. During the period in which GAO was pursuing its economic study of the drug industry with the voluntary participation of PMA and six member firms, Senator Nelson and his staff assistant Ben Gordon continued to press GAO to obtain cost data on individual drug items. On June 12, 1973, Gordon contacted a GAO official to express displeasure at the absence of any progress "in gaining access by this time" and to suggest that "the only way to gain access to the cost records will be to use force by making a formal demand through the courts." (Ahart Dep., Exhibit PA-25).

47. In late April, 1974, GAO personnel met with staff members of Senator Edward M. Kennedy's Subcommittee on Health and Senator Nelson's Monopoly Subcommittee to describe GAO's Phase I activities and its Phase II proposal. The GAO officials informed the staff members that in order to carry out the Phase II proposal GAO would have to be in a position to assure the participating firms that individual company and individual product data would remain confidential. GAO was willing to provide such assurances. The staff members rejected this approach and stated that "the only way the Subcommittees' objectives would be served. . . will be to gather and publicize specific price and cost data for individual products." (Ahart Dep., Exhibit PA-27).

48. In May, 1974, GAO personnel met with two of Senator Kennedy's staff assistants to explain the need to provide assurances of confidentiality in order to conduct the Phase II study. GAO also "discussed in some detail the difficulties in

making reasonable allocations of total drug manufacturing firm costs to the various product lines and individual products and the implications of these difficulties for any attempt to try to deal with the problem on an individual contract basis." The staff assistants, however, objected to any approach that would bar them from obtaining specific product cost information secured by the GAO. (Ahart Dep., Exhibit PA-29).

49. GAO was under no legal obligation to conform its judgment about the conduct of Phase II or any related study of the economics of the pharmaceutical industry to the views of objectives of individual Senators or their staff members. Nevertheless, the Comptroller General concluded that GAO would not pursue the study under assurances of confidentiality unless Senator Nelson and Senator Kennedy approved. (Ahart Dep., pp. 119-22 & Exhibits PA-29, PA-30).

50. In August, 1974, Comptroller General Staats met with Senators Kennedy and Nelson and explained GAO's judgment that a cooperative study of the economics of the drug industry along the lines of the Phase II proposal, including a commitment of confidentiality, would better serve the interests of GAO than would an attempt to use GAO's "access to record" authority. The Senators, however, refused to agree to GAO's proposal to provide participating companies with written assurances of confidentiality of individual product and company data. (Ahart Dep., p. 122).

51. After GAO staff conferred with Senator Nelson and obtained his approval, the Comptroller General on August 26, 1974, issued formal demand letters to the six companies who had participated voluntarily in the Phase I study, including Merck. (Ahart Dep., Exhibit PA-31; Roy Aff., Exhibit E).

52. The letters demanded access to records pertaining to 18 of several hundred drug procurement contracts entered into by the six companies during fiscal year 1974. The six companies were selected solely because they had previously volunteered to cooperate in the Phase I study. The only specific data gathered on the contracts were (1) the contract number and date, (2) the items covered, (3) the dollar amount involved, and (4) the

presence of an access to records provision. (Ahart Dep., Exhibits PA-7, PA-40).

53. At no time did either House of Congress, or any committee of either House, or any joint committee of the Congress request that the GAO seek and obtain access to cost and pricing records of Merck of any other pharmaceutical company, or request that any study involving such access not include a commitment not to disclose individual company product data. (Ahart Dep., p. 36).

54. The Comptroller General does not seek access to Merck's records in order to audit Merck's performance of any of the four contracts or to verify the basis upon which the contracting agencies determined that the resonableness of the contract prices could be judged without submission of cost or pricing data in connection with the negotiation of each of the contracts. (Defendant's Response No. 8). Nor does the Comptroller General have any other reason to audit these four particular contracts between Merck and government agencies with respect to which he has demanded access to Merck's records. As the government concedes, (1) there is no reason to believe that there was any fraud or impropriety in the negotiation or performance of the contracts (Defendants' Response No. 6(a)); (2) there is no reason to believe that the contract prices were unreasonable or that Merck made excessive profits on any of the contracts (Ahart Dep., pp. 22-23; Defendants' Response No. 3); and (3) the contract were not negotiated on the basis of cost data that might be verified by audit. (Defendants' Response No. 2(a); Ahart Dep., p. 19).

55. The Comptroller General decided to demand access to Merck's records because Merck happened to be one of the six companies who had voluntarily participated in the Phase I study. (Ahart Dep., Exhibit PA-40). And the four particular contracts listed in the demand letter to Merck were selected solely because they were among the many negotiated contracts awarded by DSA and VA within fiscal year 1974. (Ahart Dep., p. 21).

56. The Comptroller General issued the demand letter to Merck in order to obtain cost information desired by Senator

Nelson and Senator Kennedy and their staff assistants. They repeatedly had indicated an interest in obtaining raw cost data for individual pharmaceutical products for the purposes of public dissemination. (Ahart Dep., pp. 99, 123-24 & Exhibits PA-13, PA-15, PA-17, PA-32). On October 2, 1975, Comptroller General Staats informed members of a Senate subcommittee that "one of the reasons that we are interested in drug cost information" was that Senators Nelson and Kennedy and their staffs have been "anxious for us to get this kind of information." *Hearings before the Subcomm. on Reports, Accounting, and Management of the Senate Government Operations Comm.*, 94th Cong., 1st Sess. 37 (1975).

57. The other purpose of the Comptroller General's demand for access to Merck's records is to obtain data for a study of the economics of the pharmaceutical industry similar in objective to GAO's proposed Phase II study. The only changes occasioned by the adoption of the access to records approach to obtaining data for the economic study of the pharmaceutical industry was a limitation on the time period covered by the records available to GAO. (Ahart Dep., pp. 116-17 & Exhibit PA-36; Ahart Aff. ¶ 11). GAO plans to make future demands for records of drug companies if necessary to obtain sufficient data for its economic study. (Ahart Dep., pp. 155-56).

58. The use of the access to records clause to obtain confidential cost data for a study of the economics of an industry is without precedent. (Ahart Dep., p. 52). None of the five allegedly similar "industry" studies listed in Defendants' Response No. 10(b) is remotely comparable to the study of the drug industry proposed by GAO in this case. (Ahart Dep., pp. 52-87 & Exhibits PA-55, PA-56, PA-57, PA-58, PA-59, PA-60, PA-61). None of the reports attempted to make "a comprehensive and objective presentation . . . concerning the salient economic and operation aspects" of an entire industry, which is the object of GAO's study of the pharmaceutical industry. (Ahart Aff. ¶ 9; Ahart Dep., Exhibits PA-55, PA-56, PA-57, PA-58, PA-59, PA-60, PA-61):

> (a) What the defendants term the "firearms industry study" was simply the routine audit of cost information

submitted by three contractors in connection with the negotiation of their contracts for a single weapon (the M-16 rifle) to determine whether costs had been overstated by the contractor. (Ahart Dep., pp. 65-67 & Exhibits PA-55, PA-56, PA-57).

(b) The "steel fabrication industry study" involved audits of cost information submitted by a single contractor in connection with contracts for the procurement of bomb bodies for 250-pound and 500-pound bombs. (Ahart Dep., pp. 74-81 & Exhibit PA-60).

(c) The "steel (production of HY80 steel plate) industry study" dealt with procurement of a single specialized type of steel plate used in the construction of nuclear submarines. The report focused on whether the catalog prices relied upon by the Navy involved a standard commercial item sold in substantial quantities to the general public and concluded that there was no private commercial market for the products. (Ahart Dep., Exhibit PA-61).

(d) The "petroleum storage industry study" referred to in Defendants' Response No. 10 merely "evaluate[d] the relative economy to the Government of using new commercial storage facilities as [compared] to utilizing Government facilities for the storage of petroleum." (Ahart Dep., pp. 69-70 & Exhibit PA-58).

(e) The "aircraft tire industry study" consisted of a report on the General Services Administration's procedure for establishing the Federal Supply Schedule price for certain specialized military aircraft tires used by the Air Force and the Navy. (Ahart Dep., Exhibit PA-59).

59. GAO has used the access to records authority to conduct routine "contract audits" of cost data submitted during the negotiation process and to determine the propriety of charges to the government in the performance of cost-based contracts. For example, all of the contract examinations by GAO's Procurement and Systems Acquisition Division conducted pursuant to the access to record authority during fiscal

years 1974 and 1975 involved audits of cost-based contracts to determine whether contractors engaged in overpricing. None involved examinations of cost or pricing records relating to the types of contracts involved in this case, where cost and pricing information was not required or submitted during the negotiation of the contracts and the price fixed in the contract was not based on cost. (Affidavit of Paul G. Dembling in Support of Motion of the United States for Summary Judgment, sworn to on April 2, 1975, ¶ 4; Defendants' Response No. 9).

60. In undertaking its study of the economics of the drug industry, GAO is not seeking information bearing on any specific procurement problem or any particular proposals for modifications of the procurement system. GAO has no present belief that any phase of the drug procurement system established by Congress is not adequate to protect the government's interest. Cost and pricing data are being sought solely as research materials to provide GAO with "a good first hand understanding of what makes a drug firm tick." (Ahart Dep., pp. 48-51, 71; Defendants' Response No. 12).

* * *

IN THE
United States District Court
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 74-1447

MERCK & CO., INC.,
Plaintiff,
v.

ELMER B. STAATS,
Comptroller General of
the United States,
Defendant,
and

THE UNITED STATES OF AMERICA,
Defendant-Intervenor.

SUPPLEMENTAL STATEMENT OF THE UNITED STATES, DEFENDANT-INTERVENOR, PURSUANT TO LOCAL RULE 1.9(h)

Pursuant to Local Rule 1.9(h), the United States, by its undersigned attorneys, supplements the Statement of the United States of America, Defendant-Intervenor, Pursuant to Local Rule 1.9(h), by the addition of the following additional paragraphs.

1. The study based on use of GAO's access-to-records authority is being conducted in order to determine the adequacy of the protection afforded the Government by negotiating techniques used by the procuring agencies. Affidavit of Gregory J. Ahart, dated April 2, 1975, (hereinafter Ahart Aff.) para. 11-12. In order to accomplish the study GAO will use data obtained under its access-to-records authority in an attempt to ascertain the various elements which make up the

prices charged the Government for the items sold to it under the specified contracts. Defendants' Response to Plaintiff's Second Set of Interrogatories (hereinafter Defendants' Second Response) No. 8. Deposition of Gregory J. Ahart (hereinafter Ahart Dep. 1), pp. 125, 131-133.

2. The study to be conducted pursuant to GAO's access-to-records authority differs from the proposed two-phase study as originally contemplated. The two-phase study would have involved an examination of the overall operations, including research, marketing and administrative activities of sample drug companies over an extended period focusing on the cycling of products in and out of the company's available product line. Ahart Dep., pp. 116-117, Ex. PA-37; Ahart Aff., para. 6-10, Defendants' Second Response No. 11. The access-to-records study has been narrowed to include only the products procured under the specified contracts, while the time periods to be studied are governed by factors such as when the subject drug items were manufactured and when the catalog prices for these items were established. Ahart Dep., Ex. PA-37.

3. All judgments made by GAO regarding the proposed access-to-records study were made independently by the GAO staff and not made on the basis of what was perceived to be acceptable to Members of Congress or their staffs. Ahart Dep., pp. 36, 38.

4. GAO does not intend to identify individual drug firms or specific products in any report which may result from the proposed GAO study concerning the contracts here involved. Ahart Aff., para. 14; Defendant's Proposed Order appended to Supplemental Motion of the United States of America, Defendant-Intervenor, for Summary Judgment (hereinafter Proposed Order).

5. GAO will return all Merck documents received pursuant to its access-to-records authority after the study. During the study they will not be released to anyone outside the agency. Proposed Order.

6. Any request for summaries or extracts of Merck documents will be honored by the Comptroller only if it is

submitted by either House of Congress or a committee of the House or Senate or joint committee having jurisdiction over the subject matter of the study. Any request will be honored only to the extent authorized by law and then only *after* the Comptroller has notified Merck and the Court that a request has been made. Proposed Order.

7. GAO will use its best efforts to protect the confidentiality of all Merck documents and summaries or extracts of Merck documents inlcuding resort to judicial remedies, if appropriate. Proposed Order.

8. GAO has in the past used its access-to-records authority to conduct studies of the effectiveness of the Government's procurement activities as they relate to contracts with particular industries. Ahart Dep., Ex. PA-55, PA-56, PA-57, PA-58, PA-59, PA-60 and PA-61:

(a) A study of cost information pertinent to several contracts awarded to several firms in the firearms industry for the M-16 rifle. (Ahart Dep., Ex. PA-55, Ex. PA-56 and Ex. PA-57).

(b) A survey of cost information maintained by six contractors pertinent to various contracts for the fabrication of steel bomb bodies (Ahart Dep., Ex. PA-60).

(c) A study of cost records pertinent to several contracts held by two firms for the manufacture of HY-80 steel plate. Only two firms make HY-80 steel plate. Ahart Dep., Ex. PA-61.

(d) A study of Government and contractor cost records regarding the cost of construction of petroleum storage facilities. Ahart Dep., Ex. PA-58.

(e) A study of cost records pertinent to the contracts of six manufacturers of aircraft tires. Ahart Dep., Ex. PA-59.

9. The manufacture, marketing and distribution of prescription drug products sold domestically including those sold under the cited contracts (drugs), is accomplished in the Merck Sharp & Dohme Division (MSD) of Merck & Co. Inc. This

Division accumulates and records costs. Plaintiff's Response to Defendant's First Set of Interrogatories (under seal), Nos. 2, 3, 4, 5, 6 and 7 (hereinafter Plaintiff's Response).

10. Other costs incurred by Merck relating to drugs are research and development costs and general and administrative costs. The research and development costs are accumulated and recorded in the Merck Sharpe and Dohme Research Laboratories Division (Research Laboratories) while the general and administrative costs are accumulated and recorded in MSD, Research Laboratories, and Merck & Co., Inc. Plaintiff's Response, Nos. 8, 9, 10, 11, 12 and 13.

11. Merck has prepared a significant number of documents showing or evaluating the profitability of prospective or existing pharmaceutical products, Plaintiff's Response, No. 15 (under seal).

12. The following are examples of pertinent records sought by GAO for each of the drugs purchased under the cited contracts:

(1) Records reflecting the costs of manufacturing for each drug as determined by Merck's cost system. Plaintiff's Response, No. 3.

(a) Records reflecting manufacturing costs pertinent to each drug which include three elements; raw materials, direct labor, and certain variable overhead items each valued at a standard cost. Plaintiff's Response, No. 3.

(b) Records reflecting costs which are expensed during the accounting period applicable to manufacture or pricing of each drug. These include such indirect costs as depreciation, taxes on manufacturing facilities, building repairs, plant administration expenses, deletions and discards, inventory adjustments, materials management, and technical and general staff services. Plaintiff's Response, No. 3.

(2) Records reflecting the costs of marketing, advertising, promotion and distribution activities expensed

during the accounting period applicable to the manufacture or pricing of the cited drugs. Plaintiff's Response, No. 6.

(a) These costs are incurred in four main areas: selling, branches, marketing and advertising, and the area comprising medical services and marketing and sales research. Plaintiff's Response, No. 6.

(b) Examples of types of costs incurred under the four main elements are: payroll, supplies, travel, publication etc. Plaintiff's Response, No. 7.

(3) Records reflecting the costs of research and development incurred during the accounting period applicable to the manufacture or pricing of the cited drugs. Plaintiff's Response, No. 9.

(a) Examples of types of costs incurred in connection with research and development activity including, payroll, laboratory supplies, travel, publication, etc. Plaintiff's Response, No. 10.

(b) Records which show estimates of project costs used for internal planning purposes which relate to the subject drugs. Plaintiff's Response, No. 10.

(4) Records reflecting the general and administrative (G&A) costs incurred during the accounting period pertinent to the pricing or manufacture of the subject drugs. Plaintiff's Response, No. 12.

(a) Examples of G&A costs which are accumulated on a departmental basis are, payroll, travel, book and periodicals, dues and memberships, machine rentals, supplies, outside services. Plaintiff's Answer, No. 12.

(b) Examples of G&A costs which are accumulated on a corporate level are (1) executive and supportive staff service areas, with expense elements consisting of payroll, travel etc. and (2) miscellaneous expense and adjustments, which include such elements as interest, goodwill amortization, contributions, insurance etc. Plaintiff's Response, No. 12.

(5) Records which relate to studies made by management of costs or profitability concerning the subject drugs which apportion manufacturing over-head costs, and/or non-direct advertising, promotion, marketing and distribution costs and/or research and development costs and/or non-direct general and administrative costs. Plaintiff's Response, No. 15.

(6) Records which pertain to the setting or changing of the catalog and contract price for the subject drugs. (Plaintiff's Answer, No. 14). Only price changes made up to date of contract award are pertinent. Plaintiff's Response, No. 14.

Respectfully submitted,

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Dated: January 31, 1977

Opposition

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No. 81-1273

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

CHARLES A. BOWSHER, COMPTROLLER GENERAL
OF THE UNITED STATES,

and

UNITED STATES OF AMERICA,
Petitioners,

v.

MERCK & CO., INC.

ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the Comptroller General's authority to examine a contractor's records that are "directly pertinent" to a particular government contract authorizes a demand for access to all of the contractor's records of indirect and unallocated costs for all of its products solely because those costs may be covered by general corporate revenues that include the government's payments under the contract.*

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* Although respondent opposes the petition in this case, it is filing a conditional cross-petition for a writ of certiorari that would present related questions.

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v.

MERCK & CO., INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

Respondent Merck & Co., Inc.[1] ("Merck") opposes the granting of the petition for a writ of certiorari filed in this case by the Solicitor General on behalf of the Comptroller General of the United States and the United States of America.

STATEMENT

The government seeks a writ of certiorari to resolve a conflict between decisions of the Seventh Circuit and

[1] Merck's non-wholly-owned subsidiaries, set forth here in compliance with Rule 28.1, are Arramara Teoranta, Associated Pharmaceutical Products Limited, BAC Japan Co. Ltd., Calgon Far East Co., Ltd., Chemex, Inc., Ferlux Labo S.A., Ferlux S.A., Kelp Industries Pty. Limited, Kiinteisto oy Irmelinpesa, Mannings Limited, Marupi-Merck Sharp & Dohme K.K., Merck Sharp & Dohme of India Limited, Merck Sharp & Dohme (New Zealand) Limited, Merck Sharp & Dohme of Pakistan Limited, Merck Sharp & Dohme (Thailand) Ltd., and Nippon Merck-Banyu Co., Ltd.

subsequent decisions of the Second, Third, and District of Columbia Circuits in five related cases arising out of identical demands for access to contractors' records issued by the Comptroller General in August 1974.[2] The petition, however, omits important facts regarding the origin, nature, and history of this dispute that demonstrate that this case does not merit discretionary review by this Court.

The demands that spawned these cases represented a unique attempt to use the access-to-records authority granted to the Comptroller General by Congress in 1951. The decision below in no way interferes with the Comptroller General's traditional exercise of his access rights. Indeed, the impact of the decisions in these related cases is limited to a single seven-year-old set of demands. Moreover, the conflict among the circuits generated by this set of demands is now more apparent than real, since the Seventh Circuit has undermined its initial decision and the three circuits that addressed the issues thereafter are all in accord.

A. Origin Of The Comptroller General's Demands

The access-to-records demands served on Merck and five other pharmaceutical manufacturers in August 1974 were the product of efforts by two Senators and their staff aides to secure cost data on individual pharmaceutical products. Pet. App. 7a n.5; *SmithKline Corp. v. Staats*, No. 80-1464, slip op. at 3-5

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[2] *Compare Eli Lilly & Co. v. Staats*, 574 F.2d 904 (7th Cir.), *cert. denied*, 439 U.S. 959 (1978) and *United States v. Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979) (decision controlled by *Lilly*) *with Bristol Laboratories Division of Bristol-Myers Co. v. Staats*, 620 F.2d 17 (2d Cir. 1980), *aff'd by an equally divided court*, 451 U.S. 400 (1981); *SmithKline Corp. v. Staats*, No. 80-1464 (3rd Cir. Dec. 28, 1981), *conditional petition for cert. before judgment denied*, 449 U.S. 1038 (1980) (reprinted in Appendix A, *infra*); and *Merck & Co., Inc. v. Staats*, Nos. 79-1435, 79-1438 (D.C. Cir. Sept. 10, 1981), *conditional petition for cert. before judgment denied*, 449 U.S. 1038 (1980).

(3rd Cir. Dec. 28, 1981) (reprinted in Appendix A, *infra*, 3a-5a). These efforts originated in January 1971 during hearings on competition in the drug industry. At the hearings, Senator Gaylord Nelson suggested that the Comptroller General invoke his access-to-records authority in order to "take a look at" the costs incurred by pharmaceutical companies.[3]

Despite the Comptroller General's expressly stated judgment that the government was protected against unreasonable drug prices by competitive market forces and that data for individual drug items might well prove meaningless, Senators Nelson and Kennedy and their staffs pressed the General Accounting Office (GAO) to employ the access-to-records provisions as a means of obtaining drug company cost data. (C.A. App. 231-32; 474-77).[4]

GAO initially responded to this pressure by proposing a voluntary, two-phase study of the economics of the pharmaceutical industry. (C.A. App. 93-94, 105-09). Merck and five other manufacturers voluntarily stepped forward and agreed to participate in the first phase of the GAO study on the explicit understanding that it would not entail review of sensitive cost records pertaining to specific products. (C.A. App. 93).

After the companies participated in the extensive "Phase I" background study, GAO in March 1974 issued a proposal for its "Phase II" study of the economics of the pharmaceutical industry. Merck and the other companies that participated in Phase I were willing to proceed with Phase II but expressed reservations about aspects of the proposed study that would have required them to give GAO access to highly confidential cost and pricing data without adequate assurances of confidentiality. (C.A. App. 94-95, 126-27). The Comptroller General concluded that confidentiality was consistent with the type of industry economic study in which he was interested, but

[3] *Hearings on Competitive Problems in the Drug Industry Before the Subcommittee on Monopoly of the Senate Select Committee on Small Business*, 92d Cong., 1st Sess. 8020 (1971).

[4] References in the form "C.A. App." are to the joint appendix filed by the parties in the court of appeals.

the two Senators who had prompted the proposed GAO study objected since they were "primarily interested in the cost data from individual companies." (C.A. App. 317). As the Third Circuit recently found:

> "One of Senator Nelson's staff assistants, Ben Gordon, explicitly stated that specific cost and price data should be secured by individual company and product, and that 'such data should be made public.' Gordon demanded on behalf of Senator Nelson that the data be sought 'through the courts if necessary,' and 'without any strings attached so that the information could be used as needed.' Similarly, a staff assistant to Senator Edward Kennedy, chairman of a Senate subcommittee on health, insisted that the 'only way' the objectives of Senator Kennedy's subcommittee could be achieved was to 'publicize specific price and cost data for individual products.' " *SmithKline Corp. v. Staats, supra,* slip op. at 3-4 (App. A, *infra,* 3a-4a).

Bowing to the Senators' wishes, the Comptroller General on August 26, 1974, issued formal access-to-records demands to the companies that had voluntarily come forward to participate in the Phase I study. (C.A. App. 49-50, 481). As the Third Circuit concluded: "GAO's sole reason for abandoning its voluntary program and resorting to formal demands was the Senators' refusal to approve any assurances of confidentiality." *SmithKline Corp. v. Staats, supra,* slip op. at 5 (App. A, *infra,* 5a).

B. Nature Of The Access-To-Records Demand In This Case

The August 1974 demands served on Merck and the other pharmaceutical companies represented an unprecedented use of the Comptroller General's access-to-records authority. The record in this case establishes that GAO had *never before* attempted to use its access-to-records authority to collect data from contractors for an industry economic study (or any other purpose except contract audits). (C.A. App. 246-81). The unique nature of these access-to-records demands is under-

scored by the fact that *every instance* in which the Comptroller General employed his access-to-records authority in fiscal years 1974 and 1975 (the only years for which there is information in the record) involved individual audits of cost-based contracts. (C.A. App. 147). Neither the decision below nor any of the related decisions interferes with the Comptroller General's exclusive function of auditing individual contracts pursuant to his access-to-records authority.

In contrast to all of the other contracts examined by GAO pursuant to its access-to-records authority in those years, for example, the contracts listed in the Comptroller General's August 1974 access demands were all fixed-price rather than cost-based contracts. (C.A. App. 463). Merck's costs were legally irrelevant to the negotiation and performance of the contracts, because in each instance the contracting officer found competitive factors present that the procurement statutes and regulations recognize as assuring "the basic reasonableness of the price." (C.A. App. 206-07, 464). *See* 10 U.S.C. §§ 2304-(g), 2306(f). As a result, there was no actual negotiation about price and no request that Merck submit cost or pricing data to the government contracting officer. (C.A. App. 462-63).

As in each of the related cases, the pharmaceutical products supplied under the Merck contracts were standard commercial items sold in substantial quantities in the public market. (C.A. App. 462). The price proposed by Merck for each contract was based on the "catalog price" at which Merck sold the item to the general public or was otherwise determined by adequate price competition. (C.A. App. 462-63). In each instance, the price paid by the government was the lowest price at which Merck sold the product to anyone at the time the contracts were awarded. (C.A. App. 462-63).

GAO has acknowledged that its access-to-records demands were not made in order to audit Merck's contracts and that it does not suspect any impropriety by Merck or the contracting officers in connection with these contracts. (C.A. App. 44-46).

GAO also has conceded that it does not question the reasonableness of the prices charged the government in connection with these contracts. (C.A. App. 142, 216).[5]

ARGUMENT

1. Last Term, this Court granted the government's petition for review of the Second Circuit's decision in *Bristol Laboratories Division of Bristol-Myers Co. v. Staats*, 620 F.2d 17 (2d Cir. 1980), and affirmed the judgment by an equally divided Court, 451 U.S. 400 (1981). Since that time, two additional courts of appeals have examined the August 1974 access-to-records demands issued by the Comptroller General.[6] Both the District of Columbia Circuit in this case and the Third Circuit in *SmithKline* have rejected the government's position and adopted the standard approved by the Second Circuit in *Bristol*. *See* Pet. App. 3a, 38a; App. A, *infra*, 24a.

When the petition in *Bristol* was filed last Term, there was a specter of a number of widely divergent and conflicting standards emerging from these cases. That threat has not materialized. Instead, the recent decisions reflect a consensus embracing the standard espoused in *Bristol*. The rejection of the Seventh Circuit's earlier decision in *Lilly* by each of the three courts of appeals that subsequently addressed the issue not only supports the decision below on the merits but also undermines the contention that further review of the issue by this Court is warranted.

In addition, the Seventh Circuit itself has cast doubt on its decision in *Lilly*. When later confronted with the same issue that had been addressed in *Lilly*, two members of the panel concurred only because they felt bound by the earlier decision. *See United States v. Abbott Laboratories*, 597 F.2d 672, 674

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[5] As the Third Circuit emphasized in its recent *SmithKline* decision, "GAO had no reason to believe that any impropriety had occurred in connection with the contracts, that any excess or unfair profits had been made, or that any violation of the law or other irregularity had occurred." (App. A, *infra*, 5a.)

[6] *Merck & Co., Inc. v. Staats, supra; SmithKline Corp. v. Staats, supra.*

(7th Cir. 1979) (Pell, J., concurring), 675 (Wood, J., concurring). As both the Second and Third Circuits have noted, the precedential force of the *Lilly* decision within the Seventh Circuit itself "has been weakened by the reluctant concurrences of two members of the *Abbott* panel." *See Bristol Laboratories Division of Bristol-Myers Co., supra,* 620 F.2d at 18; *SmithKline Corp. v. Staats, supra,* slip op. at 25 n.7 (App. A, *infra,* 25a n.7). In view of this erosion and in view of the subsequent decisions of the Second, Third, and District of Columbia Circuits rejecting *Lilly,* there is substantial reason to expect that the Seventh Circuit would realign itself with the other circuits if it were ever presented with the issue in the future. However, since the access demands that generated these decisions were unique, it is unlikely that the Seventh Circuit or any other court will have occasion to confront the issue in the future.

2. There is no foundation for the government's assertions that review by this Court is necessary in order to avoid forum shopping and to protect against "a lack of cooperation by contractors in numerous industries and, consequently, . . . further litigation in other circuits." (Pet. 8). As noted above (pp. 4-5, *supra*), the access-to-records demands challenged in this case represented a unique use of GAO's access authority. Significantly, the government's petition fails to cite a single similar case that has been brought since the Comptroller General acquired the access-to-records authority more than 30 years ago.[7] Moreover, even though the district court decision in

[7] The decision in *Hewlett-Packard Co. v. United States,* 385 F.2d 1013 (9th Cir. 1967), *cert. denied,* 390 U.S. 988 (1968)—the only other case decided under the access-to-records statutes—did not involve the question of access to indirect cost records presented by the government's petition in this case. *See* Pet. App. 38a-39a; App. A, *infra,* 25a. The courts in *Bristol, Merck* and *SmithKline* each found the *Hewlett-Packard* decision consistent with their rejection of the sweeping interpretation of the access-to-records provision advanced by the government's petition. *See Bristol Laboratories Division of Bristol-Myers Co. v. Staats,* 428 F.Supp. 1388, 1391 (S.D.N.Y. 1977)(noting that the government's position "was implicitly rejected by the court in *Hewlett-Packard*"), *aff'd,* 620 F.2d 17 (2d Cir. 1980), *aff'd by an equally divided court,* 451 U.S. 400 (1981); *Merck & Co., Inc. v. Staats,* No. 74-1447, at 4-5 (D.D.C. Aug. 12, 1977) (Pet. App. 38a-39a), *aff'd,* Nos. 79-1435, 79-1438 (D.C. Cir. Sept. 10, 1981); *SmithKline Corp. v. Staats, supra,* slip op. at 25 (App. A., *infra,* 25a).

Bristol, which has now been followed by three circuits, was issued almost five years ago, the government has not offered a single example of a refusal by a contractor to cooperate with the GAO because of the interpretation of the scope of the access-to-records authority adopted in *Bristol* and followed by the court below.

3. The record in this case shows that the issue presented by the government involved what is, at most, a peripheral function of the Comptroller General. In 1974 and 1975, for example, GAO's Procurement and System Acquisition Division used the access-to-records authority solely to examine cost-based contracts and subcontracts totaling $814,900,000 and to recover more than $5,000,000 through the detection of overpricing. (C.A. App. 57-58). In each instance, the GAO was using its access-to-records authority in order to conduct audits of individual cost-based contracts and to check the accuracy of cost and pricing data submitted to government contracting officers during the negotiation of the contracts.

GAO has conceded from the outset that Merck's contracts and those of the other companies in this dispute are not cost-based and that it has no interest in auditing them. The decisions in *Merck, Bristol,* and *SmithKline,* therefore, in no way undermine the GAO's continued performance of its basic function of auditing cost-based contracts.

4. Contrary to the government's unsupported assertions, failure to obtain the records of indirect costs demanded in this case would not interfere with "legitimate efforts by the Comptroller General to make government-wide determinations and recommendations concerning reduction or elimination of waste and inefficiency in government contracts." (Pet. 10).

Before he acquiesed in the persistent prodding to obtain drug company cost records, then Comptroller General Staats testified that securing such data would not serve any purpose useful to GAO, because "it would be impossible to develop from [the company's] internal accounts what their costs are with respect to an individual drug." *Hearings on Competitive Problems in the Drug Industry Before the Subcommittee on Monopoly of the Senate Select Committee On Small Business,*

92d Cong., 2d Sess. 8573 (1972). He also explained that the government's interest in obtaining a fair price is adequately protected by market forces when, as in these related cases, the government purchases items at or below the price at which the manufacturer sells the products to the public at large. *Id.* at 8580-81. In view of the protection afforded the government by market forces and the inability to develop "meaningful conclusions" on an individual product basis, the Comptroller General advised Congress that any attempt to use the access-to-records authority with respect to individual contracts would simply be "a waste of time." *Id.* at 8578.

These candid and contemporaneous assessments by the Comptroller General of GAO's legitimate interests belie the arguments now advanced to grant the government a second round of plenary review in this unique and stale dispute.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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February 1982.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1464

SMITHKLINE CORPORATION,
Appellant

v.

ELMER STAATS, Comptroller General
of the United States, and
THE UNITED STATES OF AMERICA,
Appellees

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued July 16, 1981

Before: SEITZ, *Chief Judge*,
VAN DUSEN and HIGGINBOTHAM, *Circuit Judges*

(Filed December 28, 1981)

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OPINION OF THE COURT

SEITZ, *Chief Judge.*

SmithKline Corporation appeals from a final judgment of the district court granting the Government's motion for summary judgment and holding that the Comptroller General (the Comptroller) has the right of access to records of costs "of materials, labor, overhead, distribution, research and development and marketing, and such other costs as are directly pertinent to the drugs purchased" under several contracts between the United States and SmithKline. *SmithKline Corp. v. Staats*, 483 F. Supp. 712, 722 (E.D. Pa.), *conditional petition for cert. before judgment denied*, 449 U.S. 1038 (1980). This court has jurisdiction under 28 U.S.C. §1291 (1976).

I.

During 1973 and 1974, SmithKline entered into five negotiated contracts[1] to supply drugs to the Veterans Administration and the Defense Supply Agency. As required by statute, each contract contained an access-to-records provision granting the Comptroller access to "any directly pertinent" records "involving transactions related to this contract." *See* 10 U.S.C. §2313(b) (1976) (Defense Supply Agency); 41 U.S.C. §254(c) (1976) (Veterans Administration).

In 1971, Senator Gaylord Nelson, chairman of a subcommittee investigating the pharmaceutical industry, learned of the access-to-records provisions contained in certain government contracts and urged that the General Accounting Office (GAO) invoke the provisions: "I think that we ought to take a look at some of those costs." *Competitive Problems in the Drug Industry: Hearings on Present Status of Competition in the Pharmaceutical Industry Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business*, 91st Cong., 2d Sess. 8020 (1971). One of Senator Nelson's staff assistants, Ben Gordon, explicitly stated that specific cost and price data should be secured by individual company and product, and that "such data should be made public." Gordon demanded on behalf of Senator Nelson that the data be sought "through the courts if necessary," and "without any strings attached so that the information could be used as needed." Similarly, a

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1. In negotiated procurements, the Government discusses the terms of the procurement with one or more contractors, with the contract going to the candidate whose proposal is most advantageous to the Government. Negotiated contracts are to be distinguished from advertised procurements, which award contracts on the basis of competitive bids submitted by contractors. *See* Case Comment, *The Comptroller General's Authority to Examine the Private Business Records of Government Contractors:* Eli Lilly & Co. v. Staats, 92 Harv. L. Rev. 1148, 1148 n.1 (1979).

staff assistant to Senator Edward Kennedy, chairman of a Senate subcommittee on health, insisted that the "only way" the objectives of Senator Kennedy's subcommittee could be achieved was to "publicize specific price and cost data for individual products."

GAO finally concluded that it had "no viable alternative than to press the companies for access to their cost data." Initially, however, GAO sought the voluntary participation of drug manufacturers. Its appeal was successful; SmithKline and five other manufacturers voluntarily participated in the first phase of a proposed two-phase study. In April 1974, GAO issued a proposal for "Phase II," designed to "gather and develop the data necessary" to make a "presentation concerning salient economic and operational aspects of the industry." The study was to cover research and development, manufacturing, marketing, distribution, and corporate overhead. GAO requested data relevant to all these aspects of the companies' business for the period between 1964 and 1973.

SmithKline expressed reservations about giving GAO access to such cost and pricing data without adequate guarantees of confidentiality. The Comptroller was prepared to give such guarantees in the interests of completing the study. Between April and August of 1974, GAO representatives met with Senate staff to seek their consent to the assurances of confidentiality. GAO emphasized that it would obtain "far more data" from voluntary disclosure, obtained on the basis of guaranteed confidentiality, "than we could demand under our statutory authority." The staff members were unpersuaded and refused to sanction any assurances of confidentiality.

On August 26, 1974, abandoning the concept of a voluntary study, the Comptroller issued formal demand letters, seeking access to the records of the companies that had participated in the Phase I study. This step was taken with the approval of Senator Nelson. GAO was un-

der no legal obligation to accede to the Senators' demands, and the demands had not been formally made by their respective subcommittees. GAO's sole reason for abandoning its voluntary program and resorting to formal demands was the Senators' refusal to approve any assurances of confidentiality.

GAO had no reason to believe that any impropriety had occurred in connection with the contracts, that any excess or unfair profits had been made, or that any violation of the law or other irregularity had occurred. All of the contracts selected by GAO for demand letters were fixed-price procurements, with prices established not by actual negotiation, but by reference either to catalogue prices for ordinary commercial items sold in significant quantities to the general public or to other evidence of a competitive price.

SmithKline filed this action seeking a declaratory judgment that the Comptroller lacked the authority to require the production of the data demanded.[2] The Government counterclaimed for declaratory and injunctive relief to compel SmithKline to comply with the Comptroller's demand. The district court granted the Government's motion for summary judgment, holding that GAO shall have access to all of SmithKline's cost records that the Government contended were directly pertinent to the price of the drugs sold under the contracts.

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2. This case is one of several recent challenges to the Comptroller's authority to examine the records of pharmaceutical companies pursuant to the access-to-records provisions. *See United States v. Abbott Lab.*, 597 F.2d 672 (7th Cir. 1979); *Eli Lilly & Co. v. Staats*, 574 F.2d 904 (7th Cir.), *cert. denied*, 439 U.S. 959 (1978); *Merck & Co. v. Staats*, No. 74-1447 (D.D.C. August 12, 1977), *aff'd per curiam*, Nos. 79-1435, 79-1438 (D.C. Cir. September 10, 1981); *Bristol Lab. Div. of Bristol-Myers Co. v. Staats*, 428 F. Supp. 1388 (S.D.N.Y. 1977), *aff'd per curiam*, 620 F.2d 17 (2d Cir. 1980), *aff'd by evenly divided court*, 101 S. Ct. 2037 (1981).

II.

SmithKline makes two main arguments on appeal: (1) that GAO sought information from SmithKline for an improper purpose; and (2) that the scope of the demand exceeds that allowed by the access-to-records provisions. The improper purpose argument raises three distinct issues: (a) whether GAO exceeded its statutory authority to audit the performance of particular Government contracts by demanding access to confidential financial records for the purpose of conducting a general study of procurement techniques or of conducting an economic survey of the profitability of the pharmaceutical industry; (b) whether GAO exceeded its statutory authority by demanding access to confidential financial records, at the instance of two Senators and their staff aides, in order to furnish the Senators with individual company and product data through the conduct of an economic survey of the profitability of the pharmaceutical industry; and (c) whether the district court erred in granting summary judgment because the court's interpretation of the record created a material factual issue regarding the actual purpose of GAO's demand.

SmithKline's arguments are premised on the principle that an agency that is given power to investigate for one purpose cannot use that power to pursue distinctly different, unauthorized goals. *See, e.g., United States v. LaSalle National Bank*, 437 U.S. 298, 307, 316-17 n.18 (1978) (IRS subpoena power); *United States v. Garden States National Bank*, 607 F.2d 61, 68 (3d Cir. 1979) (same); *United States v. Humble Oil & Refining Co.*, 488 F.2d 953, 954 (5th Cir. 1974) (holding that the IRS exceeded its authority in issuing a summons in furtherance of a project for which the primary purpose was research rather than the investigation and adjustment of tax liabilities), *vacated and remanded*, 421 U.S. 943, *reaff'd*, 518 F.2d 747 (5th Cir. 1975); *Burlington Northern, Inc. v. ICC*, 462 F.2d 280, 286 (D.C. Cir.) (ICC re-

quest for an injunction), *cert. denied*, 409 U.S. 891 (1972). Assuming, without deciding, that the contractual powers of GAO, a unique independent agency within the legislative branch, are subject to the same restraints as those on the subpoena powers of administrative agencies,[3] we proceed to examine whether the undisputed facts support SmithKline's assertion that GAO sought access for an improper purpose.

A.

SmithKline argues that GAO exceeded its limited authority to audit the performance of particular contracts under 10 U.S.C. §2313(b) and 41 U.S.C. §254(c) because it demanded access to confidential records for the stated purpose of conducting a general study of procurement techniques. The critical premise of such a position is that Congress enacted the access-to-records provisions to prevent profiteering and fraud, and not to sanction a general scrutiny of procurement techniques or an economic survey of a particular industry. According to SmithKline, Congress sought to deter specific abuses and not to permit general investigations of the records of companies which are not in any way suspected of fraud or impropriety in their dealings with the Government.

The provisions were certainly intended to authorize access to records in cases of suspected fraud and profiteering. *See, e.g.*, 97 Cong. Rec. 13,200 (1951) (remarks of Rep. Riehlman); 96 Cong. Rec. 17,123 (1951) (remarks of Rep. Celler). Nevertheless, given that such was the primary concern, it does not necessarily follow that

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3. *See Eli Lilly & Co. v. Staats*, 574 F.2d 904, 909 (7th Cir.), *cert. denied*, 439 U.S. 959 (1976); Cibinic & Lasken, *The Comptroller General and Government Contracts*, 38 Geo. Wash. L. Rev. 349, 350 (1970) (GAO operates "on the hazy borderline between legislative and executive powers"). *Cf.* Case Comment, *supra*, at 1154-56 (discussing whether GAO is an agency).

no other purposes for the provisions exist. There is a fine line between profiteering and wastefulness, and the vast majority of the legislative references to the provisions do not indicate an intent to restrict their use to situations involving impropriety. The problems of noncompetitive pricing detailed in the congressional debates include waste in Government procurement. Representative Hardy, the sponsor of the access-to-records provisions, summarized the congressional purpose as follows: "The major purposes of this bill are twofold: One, to give the Comptroller General the proper tools to do the job the Congress has instructed him to do; and, two, to provide a deterrent to improprieties and wastefulness in the negotiation of contracts." *Id.* at 13,198. Representative Hardy further explained that examination of contractors' records by the Comptroller would enable "the General Accounting Office to look behind the [price] which had been established [to assess whether it was] excessive" and would act as a "safeguard against waste and extravagance" in Government procurement. *Id. Cf. Schwegmann Brothe . v. Calvert Distillers Corp.*, 341 U.S. 384, 394-95 (1951) (sponsor's statement of purpose is persuasive indication of congressional intent). Representative Hoffman remarked in the course of the debates that "GAO is the most effective agency we have against fraud and extravagance and waste and all those things." 97 Cong. Rec. 13,373 (1951). *See id.* at 13,199 (remarks of Rep. Hardy) (Congress "clearly understood . . . that there are a lot of other situations besides those involving fraud which might be uncovered").

SmithKline points to passages in the legislative history indicating that Congress intended only to detect fraud and profiteering with the access provisions. *See id.* at 13,373 (remarks of Rep. Hardy) (reassuring the House that exercise of the provisions would not be routine but that GAO could invoke them if it has "reason to suspect fraud or bad faith or illegality" in connection

with the contract); *id.* at 12,611 (remarks of Rep. Hardy) (stating the "sole purpose of the bill is to enable the Comptroller General to make effective audits along the lines and under the jurisdiction conferred upon the General Accounting Office by law"). We are not convinced, however, that these scattered statements are indicative of the thrust of the legislative history. The most reasonable construction of the access-to-records provisions is that Congress has authorized GAO to uncover waste by invoking them.

We also find support for our interpretation of the statute and its legislative history in the case law. *See Merck & Co. v. Staats*, Nos. 79-1435, 79-1438, slip op. at 3 (D.C. Cir. September 10, 1981) (Mikva, J., concurring in part and dissenting in part); *United States v. Abbott Laboratories*, 597 F.2d 672, 674 (7th Cir. 1979); Eli Lilly & Co. v. Staats, 574 F.2d at 915-16. *But cf.* Note, *Government Contracts: Contractor's Obligation to Allow Examination of Records Under 10 U.S.C. §2313(b)*, 72 Dickinson L. Rev. 687, 691 (1968) (stating that access provisions were intended "solely to provide a method to discover fraudulent activities," but recognizing that "there is nothing in the Act specifically negating" the possibility that Congress sought to improve general procurement techniques).

Although the statute and its legislative history do not specifically indicate that Congress intended to authorize GAO studies of procurement techniques, they authorize GAO to seek information that will help the Government reduce wastefulness and that is "directly pertinent" to the contract. Acquiring data for studies of procurement techniques seems a reasonable means to the end that Congress intended. In light of our own review of the statutes and their legislative history, we are unpersuaded that GAO's interpretation of the access-to-records provisions as allowing such access is unreasonable. *See Hewlett-Packard v. United States*, 385 F.2d

1013, 1016 (9th Cir. 1967) (noting that, if production costs are "out of line with the contract price, the contract may have been an inappropriate means of meeting this particular procurement need. . . . [and this approach] could lead to the use of other methods of meeting future procurement needs"), *cert. denied*, 390 U.S. 988 (1968).

Great weight is traditionally accorded to the construction of a statute by the agency charged with its administration "unless there are compelling indications that it is wrong." *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1969). SmithKline points to evidence that GAO has expressly and impliedly indicated, in letters to congressional committees at the time the statute was enacted, in internal memoranda, and in recommendations that Congress grant it additional authority, that it lacks the power to examine records relating to nongovernment business activities or to conduct "should cost" studies. SmithKline also contends that GAO has never previously conducted economic "industry" studies. At the most, SmithKline's evidence suggests that the GAO has changed its interpretation. More likely, GAO's interpretations represent GAO's search to discover which tasks are reasonably related to its responsibility for overseeing Government purchases. In any case, we believe that GAO has correctly concluded that it has the statutory authority to make the studies that it has proposed.

Nor do we think it determinative that Congress has only once granted GAO a right of access to records of government contractors for the purpose of conducting an economic study, or that in 1973 and 1975 Congress declined to act on several proposals drafted by GAO that would have granted GAO access to contractors' records in order to conduct profit studies of Government contractors. *See, e.g., American Trucking Associations v. Atchison, Topeka & Santa Fe Railway*, 387 U.S. 397, 418 (1967) (agency's request for legislation is not re-

garded as administrative interpretation of enabling statute); *United States v. UMW*, 330 U.S. 258, 281-82 (1947) (subsequent legislative history declaring intent of an earlier statute not controlling). Relying on the fact that Congress did not pass a bill to interpret a bill that Congress passed many years earlier is inherently suspect. Such inaction certainly does not indicate that Congress itself has concluded that the provisions themselves do not grant authority for the studies. The issue here is whether the access-to-records provisions now before us can reasonably be read to permit the GAO's present demand. We conclude that they can.

Assuming that GAO actually seeks SmithKline's records for the purpose of conducting an economic study of the pharmaceutical industry, we believe that it is a small step to find that the Comptroller's audit responsibilities include the study not only of the firms that contract with the Government but also the industries of which the firms are a part. GAO must have some understanding of an industry before it can study an individual procurement effectively. The Comptroller's Phase II demand in this case is equivalent to a request for access to records relevant to a cost-price comparison of each contract for the purpose of determining whether there has been "wastefulness" in pharmaceutical procurement. That the GAO will facilitate its comparison by compiling an industrywide economic study or procurement techniques study does not vitiate that purpose.

B.

SmithKline also argues that the record clearly demonstrates that GAO seeks access to SmithKline's confidential business records to undertake an economic study of the pharmaceutical industry in response to intense and continuing pressure from two Senators and their staff aides who wish to obtain, for public disclosure, cost and pricing data relating to specific products and manu-

facturers.[4] Assuming, as we must, for purposes of reviewing the district court's summary judgment, that SmithKline could prove that GAO is seeking to obtain information for an industrywide economic study that would provide Senators Nelson and Kennedy with the information they sought, we cannot hold that GAO's purpose is improper. The statutory requirement that the access-to-records provision be included in the contracts establishes the public interest in uncovering wastefulness and extravagance. That United States senators encourage and influence GAO to use its powers to the fullest extent allowed by law, and that GAO heeds those Senators, is irrelevant. *See* Parnell, *Congressional Interference in Agency Enforcement: The IRS Experience*, 89 Yale L.J. 1360, 1368 (1980), quoting *Gravel v. United States*, 408 U.S. 606, 625 (1972) (noting that "members of Congress 'are constantly in touch with the Executive Branch of Government — they may cajole, and exhort with respect to the administration of a federal statute' "). We believe that a demand letter issued by GAO pursuant to its statutory authority, under the continuing and intense pressure of United States senators, may not, with-

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4. We do not understand SmithKline's argument to be that, assuming GAO lawfully has acquired information — under the pressure from the Senators — for the purpose of preparing an industrywide economic study, it cannot turn it over to individual senators. Rather, we believe that SmithKline's argument is simply that "the central purpose underlying the Comptroller General's demands was to obtain exploitable cost information, desired by two Senators and their aides, through the conduct of a broadranging study of the economics of the pharmaceutical industry." We therefore need not address what limits, if any, exist on GAO's ability to disclose information obtained by invocation of the access-to-records provisions.

The parties have agreed to provisions that substantially protect the confidentiality of the records. *See SmithKline*, 483 F. Supp. at 723-24 (confidential information may only be disclosed if: (1) identification of SmithKline as the source of the information is impossible; (2) if a committee or chamber of Congress requests the information; or (3) if a subpoena is issued for the information).

out more, be resisted on the ground that GAO sought the information for an improper purpose.

In *SEC v. Wheeling-Pittsburgh Steel Corp.*, 648 F.2d 118 (3d Cir. 1981) (en banc), we indicated that "we will not countenance judicial interference with agency decisions to conduct investigations, decisions that are committed entirely to agency discretion. . . ." *Id.* at 127 (citing, e.g., *City of Chicago v. United States*, 396 U.S. 162, 165 (1969)).[5] The reason for this policy of noninterference was recently stated by the United States Court of Appeals for the Fifth Circuit: "Judicial supervision of agency decisions to investigate might hopelessly entangle the courts in areas that would prove to be unmanageable and would certainly throw great amounts of sand into the gears of the administrative process." *Dresser Industries, Inc. v. United States*, 596 F.2d 1231, 1235 n.1 (5th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980). We believe those same concerns support our result in this case. Moreover, although the courts that have considered whether GAO may investigate fraud and whether it was motivated by a proper purpose in investigating the pharmaceutical industry have taken an approach different from our own, *see Lilly*, 574 F.2d at 910-12 (finding speculation about senatorial prodding unnecessary if GAO otherwise has a legitimate purpose); *Merck*, slip op. at 4-5 (Mikva, J., concurring in part and dissenting in part) (same); *SmithKline*, 483 F. Supp. at 720-21, no court has found that GAO is pre-

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5. In *Wheeling-Pittsburgh*, this court recognized that the enforcement of an SEC subpoena may be challenged where the agency is abusing the court's process. *See* 648 F.2d at 125. Although this case was called to counsels' attention at oral argument, SmithKline does not contend that this case is controlling in the present circumstances. Indeed, SmithKline does not allege that GAO is acting in bad faith in seeking access to the information. *Cf. id.* at 125 n.9 (defining agency bad faith as "a conscious decision by an agency to pursue a groundless allegation without hope of proving that allegation").

cluded from demanding records from pharmaceutical firms because of an improper purpose.

C.

SmithKline argues that at a minimum this court must decide that material issues of fact regarding the actual purpose of the Comptroller exist, thus rendering summary judgment for the Government inappropriate. We have concluded, however, that, assuming GAO sought to conduct a broad economic study of the pharmaceutical industry in order to provide cost and pricing data to individual Senators, GAO did not invoke the access-to-records provisions for an improper purpose. Thus, SmithKline's contention is without merit, because the issue as to the Comptroller's actual purpose is not material to our legal conclusion.

III.

SmithKline also alleges that the district court erred in its determination of which records may be considered "directly pertinent" to "transactions relating to" the contracts. SmithKline makes two arguments as to the scope of access: (1) cost records are pertinent only to cost-based contracts; and (2) even if some cost data is pertinent to fixed-price contracts, the district court failed to set any reasonable limits on the scope of GAO's access.

A.

The five contracts at issue are fixed-price contracts. The prices were established by reference either to catalogue prices for ordinary commercial items sold in significant quantities to the general public or to other evidence of competitive price. SmithKline argues that cost data cannot be "directly pertinent" to "transactions related to this contract" where the price is fixed not in refer-

ence to a standard of fairness in negotiating or to costs, but to catalogue, market, or competitive prices. In support of this interpretation of sections 2313(b) and 254(c), SmithKline points to limitations in the Truth-in-Negotiations Act, 10 U.S.C. §2306(f) (1976), and in the Renegotiation Act of 1951, 50 U.S.C. §1216(e) (1976), on the submission of cost data for the negotiation or renegotiation of contracts based on established catalogue prices or adequate price competition. SmithKline argues that these statutes and the regulations promulgated thereunder provide important evidence that similar restrictions are incorporated in sections 2313(b) and 254(c) through the language limiting access to material "directly pertinent" to "transactions relating to" the contract. SmithKline contends that, in the absence of convincing evidence that different interpretations were intended, interrelated statutory provisions should be given a harmonious construction. *See Kokoszka v. Belford*, 417 U.S. 642, 650 (1974). SmithKline maintains that in this area of Government procurement Congress has consistently recognized that the presence of competition is a sufficient substitute for other safeguards against contractor abuse.

Both the statutory and the contractual provisions clearly apply by their terms to negotiated contracts without qualification. If Congress had desired to exclude fixed-price contracts from the provisions' operation, it could have explicitly done so, as it did in the Truth-in-Negotiations Act and in the Renegotiation Act. *See Lilly*, 574 F.2d at 916; *Hewlett-Packard*, 385 F.2d at 1016. Moreover, SmithKline's contention that the access-to-records provisions do not extend to costs conflicts with the language of the provisions. Not only has SmithKline contracted to disclose some "directly pertinent" records in its possession, but it has also contracted to put a provision in its subcontracts securing access for GAO to the "directly pertinent" records of its subcontractors. If the position now urged by SmithKline that the

statute and contract do not allow access to any cost records is correct, the provision for access to the records of SmithKline and of its subcontractors would be a nullity. The purpose of the access-to-records provision is to allow GAO to assess the reasonableness of the contractors' costs and pricing by insuring full access by the Comptroller to all directly pertinent cost and pricing records, including subcontractors' records that otherwise might be unreachable because they would not be in the custody and control of the contractor. Thus, SmithKline's reading ignores a large portion of the provision itself and violates the well-established rule that a contract and a statute should be read so as to give meaning to all their provisions.

SmithKline argues that, because the access-to-records provisions are dictated by statute, they cannot be individually tailored to meet the specific requirements of each contract. The Government, SmithKline contends, can take no comfort from the fact that the access clauses seem to envisage the production of subcontractor records that appear to be relevant to the issue of costs and pricing. This clause is required by the statute whether or not SmithKline planned to use subcontractors in the performance of the particular contract. SmithKline argues that similarly the clause is required whether the subcontractor's performance will be "directly pertinent" to the particular contract or not.

Congress has by statute required a provision in every contract that in some instances has no application because the contractor does not employ a subcontractor. The possibility that a standard contractual provision will have no application in one contract does not, however, render it meaningless in another contract where it could have application. Thus, we think that cost records can be directly pertinent to fixed-price contracts and that an access-to-records provision in such a contract gives GAO the authority to request directly pertinent data. *See Lilly*, 574 F.2d at 916.

B.

Determining that the statutory provision does not exempt fixed-price contracts does not necessarily mean that all costs that affect the price of the drug covered in the contract are directly pertinent to the contract. Representative Hardy used the following examples to illustrate the situations which his bill was designed to reach:

> It is common practice today to provide in a contract for construction work a fixed overhead rate, either as a proportion of direct labor costs or as a lump sum amount. . . .
>
> If in the course of checking the accounts of the accountable officer, the GAO found a situation indicating that the amount of overhead charged under the Government contract was a great deal higher than the amount paid under a private contract for the same work, it would then obviously be desirable for the General Accounting Office to look behind the rate which had been established. . . .
>
> During the last war, there were cases where contractors held both fixed-price and cost-plus-a-fixed-fee contracts covering similar items or services, both contracts being performed simultaneously and in the same plant. In several cases it was found that the contractor was charging to the cost-plus-a-fixed-fee contract expenses which should have been charged to the fixed-price contract. In that way he was being reimbursed for expenses which should have been paid out of his own pocket. Such a practice may, or may not, have been intentional. But in any event, there would be little or no chance of detecting such a practice, unless the General Accounting Office has access to the contractors' books and records.

97 Cong. Rec. 13,198 (1951). For GAO to detect a differential allocation of overhead costs between governmen-

tal and nongovernmental contracts, or between cost-plus and fixed-price contracts, it would have to examine a very broad set of records. *See* Case Comment, *supra*, at 1157-58 n.67. The implication of Representative Hardy's examples is that the legislation was intended to authorize inquiry not only into all costs associated with each negotiated government procurement contract, but also into all similar contracts between a particular contractor and his private buyers, in order to determine whether the government was bearing an excessive share of the company's fixed costs. It is clear, however, that Congress did not intend the "directly pertinent" language to allow GAO to examine records of costs recovered exclusively from nongovernmental contracts. *See Merck*, slip op. at 27 (Mikva, J., concurring in part and dissenting in part); Memorandum on the Adequacy of the Legal Authority of the General Accounting Office to Conduct a Comprehensive Study of Profitability in Defense Contracting, *reprinted at* 115 Cong. Rec. 25,800 (1969) [hereinafter GAO Memorandum] (GAO has taken the position "that the words 'directly pertinent' were intended only to limit GAO's right of access to records pertaining to Government work as distinguished from non-government work").

The bill that contained sections 2313(b) and 254(c) originally limited the Comptroller to "pertinent" records of the contractor. Representative Hoffman emphasized in debates over the access-to-records provision that he objected strongly to "snooping expeditions" and that the access-to-records provisions would allow GAO "unlimited authority to go everywhere and snoop into everybody's business." 97 Cong. Rec. 13,373 (1951) (also stating opposition to a statute that "would let GAO go into everybody's business and look it over"). To prevent an expansive interpretation of the provisions, Congress restricted the access proposal even further, by specifying that only records "directly" pertinent to the contract may be demanded. Representative Hoffman,

who sponsored the limiting amendment but opposed the original bill, *see* 97 Cong. Rec. 13,377 (1951), stated specifically that the purpose of the modifying language was to "limit the 'snooping' that may be carried on under this bill." *Id.* Representative Hoffman emphasized that, unless the proposed bill were limited, even a small government contract would open all of a contractor's records to inspection by GAO. He pointed out that, without amendment, the provisions would permit a contract for ten percent of a contractor's production to be inspected by GAO "not only with reference to that one item of 10 percent . . . but into all of his other business where that same item was used." *Id.* He feared this result because the contractor would inevitably fail to keep "a separate set of books" for his government business, so that: "every section of his books will have to come under the complete scrutiny of the GAO. He is going to be harassed no end to try to break down production costs and show the details. . . ." *Id.* at 13,376 (remarks of Rep. Harvey). Although these statements were offered in support of a proposed amendment relating to subcontractors, we believe that the same apprehension stimulated the introduction and adoption of the limiting "directly pertinent" language.

The Government argues that Congress' addition of the word "directly" did not sharply narrow the scope of inquiry to be allowed GAO. *See* Case Comment, *supra*, at 1157-58. *But see* Note, Eli Lilly & Co. v. Staats: *An Undue Expansion of the GAO's Investigatory Power Under the Access-to-Records Statutes*, 74 Nw. U.L. Rev. 122, 135 (1979) [hereinafter Nw. Note]. It is true that Representative Hardy did not oppose the amendment. *See* 97 Cong. Rec. 13,377 (1951). It is also true that Representative Hoffman did not indicate how his change would affect GAO's ability to secure specific documents. *See id.* On the other hand, a sponsor's statement of purpose generally is regarded as a persuasive indicator of congressional intent. *See Federal Energy Administra-*

tion v. Algonquin SNG, Inc., 426 U.S. 548, 564 (1976). In any case, we do not believe that the insertion meant nothing just because there was little debate on the change.

The legislative history manifests a strong congressional intent to prevent unlimited "snooping." "[W]hen Congress enacts a statute designed to limit government intrusion in the private affairs of its citizens, the statutory provisions must be followed scrupulously." *United States v. Bacheler*, 611 F.2d 443, 447 (3d Cir. 1979). We thus conclude that the contract does not provide for unlimited access to SmithKline's cost records.

When cost information is not allocated to specific contracts and their products, the Government's argument that generalized cost data are "directly pertinent" to any given contract is weakened. *See* Nw. Note, *supra*, at 132. Like most manufacturing businesses, SmithKline divides its costs into a small category of direct manufacturing costs that can be readily assigned to a particular product and into other categories of cost, including research and development, distribution, marketing, advertising, and administrative costs, which are not assigned to any one product. *See* Reekie, *Price and Quality Competition in the United States Drug Industry*, 26 J. Indus. Econ. 223, 235 (1978); Nw. Note, *supra*, at 132-33. *Cf.* National Association of Cost Accountants, *Research Series No. 29, Accounting for Research and Development Costs*, 36 N.A.C.A. Bull. 1375, 1427-30 (1955) (survey finding that some businesses assign research and development costs to particular products, but some do not because the arbitrary method of allocation would not be helpful). SmithKline maintains that this common practice reflects the lack of generally accepted accounting principles that permit accurate and meaningful allocation of these indirect costs.

Obviously, however, these unassigned costs affect the price charged for the company's products, because the company must recover both the costs directly as-

signed and the unassigned pooled costs. Manufacturing and distribution costs of individual pharmaceutical products may constitute as little as nine percent of the products' sale price. *See Lilly*, 574 F.2d at 913; Rucker, *Public Policy Considerations in the Pricing of Prescription Drugs in the United States*, 4 Int'l J. Health Services 171, 173 (1974).By characterizing unallocated costs as "directly pertinent" to government procurement contracts, GAO would be able to demand access to all records of pooled costs whenever the price charged the Government in the contracts at issue reflects costs attributable to the pool. GAO would thus have access to most, if not all, of SmithKline's pricing data.[6]

The Government, on the other hand, rejects both the argument that there are no generally accepted accounting principles that permit meaningful allocation of these indirect costs and SmithKline's suggestion that GAO's interpretation of the access provision would be without limits. The Government argues that SmithKline itself allocates costs to products and performs profitability studies for its own purposes; even if allocation of indirect costs to products cannot be made with scientific accuracy, it is helpful and necessary. The Government contends that there is almost no limit to the allocation of costs to particular products other than that set by expediency. The Government maintains, however, that it will not need certain information or information breakdowns and thus that its request for information is not without bounds. In short, the Government's contention is that any cost affecting the prices charged the Government under a given contract may be "directly pertinent" to the

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6. If GAO were allowed access to this information, it would presumably have to make a similarly arbitrary allocation. Thus, denying or granting access to such records will have little effect on GAO's ability to evaluate the contractor's pricing practices on a *particular* contract. *See* Nw. Note, *supra*, at 134. The information would, however, be useful in determining the extent of differential allocation between contracts.

contract. *See Lilly* 574 F.2d at 914-15 (finding that an item is directly pertinent to a contract if it is a "significant input" in the price of the product purchased in the contract).

We believe that the Government's argument undermines its own position, for it would seem that the Government's interpretation of "directly pertinent" admits of no doctrinal limitation on its access powers. We are unwilling to read the statutory provision as granting to GAO such broad discretion in determining what is pertinent and what is "snooping." The Government has not suggested a definition of "directly pertinent" that preserves the distinction between snooping and properly limited access. Indeed, its argument gives the phrase no effect in this case. If a "directly pertinent" cost record means any cost having a significant input into price, it would seem that GAO could also justify an extensive investigation of subcontractors who may actually be doing no Government business at all. *Cf.* Morgan, *The General Accounting Office: One Hope for Congress to Regain Parity of Power with the President*, 51 N.C. L. Rev. 1279, 1364-65 (1973) ("The same argument that would justify a GAO audit in *Hewlett-Packard* would justify an audit of contractors doing no government business at all."). We do not think that an interpretation of the "directly pertinent" language that allows practically unlimited investigation of companies that do no direct business with the Government can be sound in light of the congressional desire to prevent snooping.

The Government contends that GAO's administrative interpretation of "directly pertinent" should be followed in the absence of "compelling indications that it is wrong," especially where those interpretations were reported to Congress. We believe, however, that Congress' inaction in the face of the report should not be read as acquiescence. *See Girouard v. United States*, 328 U.S. 61, 69 (1946). GAO's broad interpretation of the provisions is inconsistent with the congressional intent and is

entitled to no deference. *Cf.* Nw. Note, *supra*, at 135 n.77 ("The GAO itself has been uncertain about the exact limits of its authority under the access-to-records statutes."). We must therefore search for a more limited interpretation if "directly pertinent" is to be given an interpretation consistent with the congressional history.

In some industries, costs such as research and development have such a small impact that they arguably are not "directly pertinent" to the contract and its price. *See Lilly*, 574 F.2d at 913-14. Whether a cost record is "directly pertinent" could vary from industry to industry. *See Merck*, slip op. at 26-27 (Mikva, J., concurring in part and dissenting in part). In some industries, direct costs are the predominant component of a product's price, and there would be no need to grant access to indirect cost information of those firms. But in the pharmaceutical industry, research and other costs not immediately attributable to one product form a large part of the costs of a pharmaceutical product. Each case could be decided on its facts by addressing one question: whether the records sought will show production costs and pricing of the contracts sufficient to determine why the contract price was fixed as it was and whether "the contract may have been an inappropriate means of meeting this particular procurement need of the Government." *Hewlett-Packard*, 385 F.2d at 1016. The judicial decision as to what records are necessary would thus be essentially an accounting problem which is not unlike those problems which are common in day-to-day discovery involving corporations. *See generally United States v. IBM Corp.*, 66 F.R.D. 186 (S.D.N.Y. 1974); Fed. R. Civ. P. 33(c).

Although it is tempting to take the opportunity to make the decision as equitably as possible in each case, we are not convinced that Congress intended for the interpretation of the access-to-records provision to depend on the facts of each case. The same provision appears in

most Government contracts. *See* Nash, *Risk Allocation in Government Contracts*, 34 Geo. Wash. L. Rev. 693, 694 n.3 (1966) (finding that only one quarter of all Government procurement contracts are advertised procurements). We believe that Congress intended the words to acquire some common meaning so that the Government and the contracting firm could know within reason what they were contracting to perform. In contracts involving many millions of dollars, many firms, and many products, certainty is more important than deciding each case on its facts.

In *Bristol Laboratories Division of Bristol-Myers Co. v. Staats*, 428 F. Supp. 1388 (S.D.N.Y. 1977), *aff'd per curiam*, 620 F.2d 17 (2d Cir. 1980), *aff'd by evenly divided court*, 101 S.Ct. 2037 (1981), the district court equated the directly pertinent costs with "manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision); manufacturing overhead (including plant administration, production planning, warehousing, utilities, and security); royalty expenses; and delivery costs." 428 F. Supp. at 1389. *See id.* at 1391. Specifically excluded, however, were data with respect to "research and development, marketing and promotion, distribution and administration (except to the extent that these areas may be included in the factors above)." *Id.* at 1389-90. The Government has not put forward an alternative definition of "directly pertinent" records that we should adopt if we do not agree with its interpretation of the statute. We therefore adopt the standard formulated in *Bristol*, which for the most part relies on the distinction between direct and indirect costs. We believe that it comports with Congress' intent to preclude GAO's scrutiny of nongovernmental contracts. Moreover, our distinction between information that is "directly pertinent" and that which is not follows the distinction drawn by every circuit to consider the issue with the exception of the Sev-

enth Circuit.[7] *See Merck*, No. 74-1447, slip op. 4-5 (D.D.C. August 12, 1977), *aff'd per curiam*, Nos. 79-1435, 79-1438 (D.C. Cir. September 10, 1981).

The Government argues that GAO's interpretation that the access-to-records provision provides for the access it seeks here has been well-known and judicially established since the *Hewlett-Packard* decision in 1967. We do not believe, however, that the Ninth Circuit sanctioned access to all indirect overhead cost data. The Ninth Circuit held that GAO should have access to "production costs." 385 F.2d at 1016. Although the court never defined these costs, the district court's order, affirmed by the court of appeals, referred specifically to "costs of direct material, direct labor and overhead costs." *Id.* Our decision includes direct costs and some overhead within its definition of "directly pertinent." How much overhead the Ninth Circuit intended to include is uncertain. *See Merck*, slip op. at 23 n.27 (Mikva, J., concurring in part and dissenting in part) ("Later decisions have disagreed over the *Hewlett-Packard* holding on this point."). *Compare Lilly*, 574 F.2d at 913, *with Bristol*, 428 F. Supp. at 1391. Thus, *Hewlett-Packard* does not necessarily suggest a result contrary to that in our case.

We have concluded that GAO may demand access to detect wastefulness and may make certain studies to help it in its task. We are aware, however, that the limiting interpretation that we have given the access-to-records provision may make it more difficult in some cases for GAO to obtain the information it may

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7. We note that in *Abbott Laboratories* another panel of the Seventh Circuit addressed precisely the same issues as those addressed in *Lilly*. The district court had granted summary judgment to the Government on the basis of *Lilly*, and the circuit court affirmed. Two of the three judges, however, specifically expressed reluctance and concurred in the affirmance solely because they considered themselves bound by the earlier decision. *See* 597 F.2d at 674 (Pell, J., concurring); *id.* at 675 (Wood, J., concurring).

need to uncover wastefulness.[8] Economic studies based on such restricted data may be of limited utility, and if the access provisions were meant to equalize the relationship between the Government and private contractors, our reading of the clause fails to advance fully that purpose in this case. *See* Merck, slip op. at 20-21 (Mikva, J., concurring in part and dissenting in part). The difficulty, however, arises because (1) the statute attempts to further the two conflicting congressional goals of limiting "snooping" and permitting broad access; and (2) the pharmaceutical industry presents special characteristics. The conflict in goals appears on the face of the statute itself. *Cf.* Nw. Note, *supra*, at 139 ("there can be no accommodation of the competing interests; either the GAO gets all of the information or it gets none of it"). For example, the fact that the demand is limited by the access-to-records provisions to data within three years of final payment, *see* 10 U.S.C. §2313(b), no doubt hampers the detection of wastefulness and the usefulness of any studies that are prepared. Congress also restricted GAO's investigatory powers by not making the access-to-records provisions applicable to advertised as well as negotiated contracts. Information on producers doing no business with the Government would undoubtedly also be useful in the overall improvement of Government procurements, since the data could be compared

8. In industries where direct costs are the prime component of price, where firms are producers of only one product, or where the firms sell almost everything they make to the Government, our decision will have little limiting effect on GAO's ability to make various studies. With other firms, manufacturing cost information alone might be useful for two purposes: (1) it might help to uncover fraud; and (2) where the products are part of a competitive market, which most fixed-price cost contracts, by definition, are, comparison of direct cost information could help the Government determine which company is assigning more overhead to its product. Nevertheless, we realize that our decision will limit to varying degrees GAO's ability to study any industry with firms that make several products or have several buyers.

with the data collected from companies contracting with the Government; but GAO cannot obtain that information under the provisions. *See* Morgan, *supra*, at 1364-65. We do not believe that we are free to ignore these limitations in trying to assure that GAO has meaningful access to the contractors' records.

GAO has itself recognized its dilemma: "While GAO's legal authority would permit it to perform some of the work necessary in making a profit study. . . ., to do a meaningful study of profitability . . . , legislation should be enacted broadening its right of access to records. . . ." GAO Memorandum, *supra*, *reprinted at* 115 Cong. Rec. 25,801 (1969). "In establishing the 'directly pertinent' standard as a limitation on the GAO's access rights, Congress apparently was willing to forego obtaining all the information that might be related to a government contract if the only alternative was to require a contractor to make available virtually all of its records." Nw. Note, *supra*, at 134-35 (footnote omitted). If "directly pertinent" information is not sufficient to make the Comptroller's investigation of certain industries complete, or if certain industries should be treated differently because of unique circumstances, Congress, and not this court, is better able to decide which information GAO needs to fulfill Congress' expectations.

SmithKline must allow GAO personnel to inspect its records with respect to manufacturing costs, manufacturing overhead, royalty expenses, and delivery costs. SmithKline need not produce data with respect to research and development, marketing and promotion, distribution and administration, except to the extent that these costs may be included in the manufacturing costs.

IV.

The order of the district court will be vacated and the case remanded for entry of an order consistent with this opinion.

A True Copy:

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Clerk of the United States Court of Appeals for the Third Circuit

Petitioner's Reply Brief

Supreme Court, U.S.
FILED
MAR 23 1982
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CLERK

No. 81-1273

In the Supreme Court of the United States

OCTOBER TERM, 1981

CHARLES A. BOWSHER, COMPTROLLER GENERAL OF THE UNITED STATES, AND UNITED STATES OF AMERICA, PETITIONERS

v.

MERCK & CO., INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONERS

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---

1. Respondent acknowledges that when this Court granted the government's petition for a writ of certiorari last Term in *Bristol Laboratories* v. *Staats*, 451 U.S. 400 (1981), there existed a "specter of a number of widely divergent and conflicting standards," but it contends that "[t]hat threat has not materialized" (Br. in Opp. 6). In fact, the divergence of authority existing then remains just as real today. The split between the Seventh Circuit[1] and the

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[1] *Eli Lilly & Co.* v. *Staats*, 574 F. 2d 904 (7th Cir.), cert. denied, 439 U.S. 959 (1978); *United States* v. *Abbott Laboratories*, 597 F. 2d 672 (7th Cir. 1979).

Second, Third and District of Columbia Circuits[2] continues to divide the federal courts on an important issue of statutory construction requiring resolution by this Court.

Respondent places primary reliance on its contention that the access demands in these cases are "unique" (Br. in Opp. 7) and, therefore, that the situation presented here is not likely to recur. This argument tends to obscure the fact that the issue presented is one of statutory construction—whether the Comptroller General is authorized by law to examine a contractor's records pertaining to nonallocated costs—that could be implicated in any request for records issued by the Comptroller General. It is, accordingly, an issue that is not limited in the fashion respondent suggests and one that requires national uniformity (see Pet. 8).

Indeed, respondent's assertions (Br. in Opp. 6) concerning an emerging "consensus embracing the standard espoused in" *Bristol Laboratories* v. *Staats*, 620 F. 2d 17 (2d Cir. 1980), aff'd by an equally divided court, 451 U.S. 400 (1981), seem particularly hollow in the circumstances of this case. The court of appeals majority affirmed the judgment of the district court only because "[t]he scope and meaning of the statutory access-to-records provision have been thoroughly considered in the decisions we have cited. Conflicts in those decisions must be resolved by the Supreme Court, not by us, and we believe that nothing would be gained by a replowing of the field" (Pet. App. 3a). Judge Mikva agreed with the majority that the conflict among the circuits "must be resolved by the Supreme Court" (*id.* at 4a), but he proceeded to discuss the merits of the case and concluded

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[2] *Bristol Laboratories* v. *Staats*, 620 F. 2d 17 (2d Cir. 1980), aff'd by an equally divided court, 451 U.S. 400 (1981); *SmithKline Corp.* v. *Staats*, 668 F. 2d 201 (3d Cir. 1981); *Merck & Co.* v. *Staats*, 665 F. 2d 1236 (D.C. Cir. 1981) (Pet. App. 1a-32a).

that the Second Circuit erred in restricting the Comptroller General's statutory right of access.

2. In a nutshell, respondent contends that the record access demand at issue here involves "a peripheral function" and that the decision below "would not interfere with 'legitimate efforts by the Comptroller General * * *' " (Br. in Opp. 8). This is simply a retread of respondent's arguments that were specifically rejected by the district court (Pet. App. 36a-38a) and that are not supported by the record (see C.A. App. 40-44, 146). In fact, GAO has in the past conducted surveys—such as the one proposed here—of the effectiveness of government procurement activities in particular industries.[3]

Respondent's contention that the access-to-records provisions do not apply to fixed-price contracts was rejected by the district court (Pet. App. 36a, 38a) and by every appellate court to pass on the question. *Hewlett-Packard Co.* v. *United States*, 385 F. 2d 1013 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968); *Eli Lilly & Co.* v. *Staats*, 574 F. 2d 904, 916 (7th Cir.), cert. denied, 439 U.S. 959 (1978); *SmithKline Corp.* v. *Staats*, 668 F. 2d 201, 208-209 (3d Cir. 1981). The assertion that GAO does not examine records of fixed-price contracts is, moreover, flatly wrong. Both the examination underlying the *Hewlett-Packard* case and the survey of the steel plate industry (see note 3, *supra*) involved fixed-price contracts.

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[3]For example, GAO has issued reports involving contracts with the petroleum storage industry (Report No. B-133149, February 28, 1963), the steel plate (HY-80) industry (Report No. B-148772, June 29, 1965), the steel fabrication industry (bomb bodies) (Report No. B-118710, December 11, 1969), the aircraft tire industry (Report No. B-146753, February 20, 1963), and the firearms industry (Report No. B-161710, September 10, 1968; Report No. B-164313, November 18, 1976). See C.A. App. 148, 501.

Although respondent is incorrect in asserting that the request for records involved in the pharmaceutical industry cases are unique, the fact remains that—even if these were the first access demands under fixed-price contracts—this is not "a peripheral function of the Comptroller General" (Br. in Opp. 8). First, the contracts under review in the pharmaceutical study involve costs to the government in excess of $14 million.[4] Second, the question presented—which addresses the scope of the Comptroller General's record access authority—is not necessarily limited to fixed-price contracts, and the interpretation by this Court of the relevant statutory and contractual provisions could affect GAO's power to request records related to any contracts. The question is thus an important one with broad implications for the Comptroller General's ability to fulfill his statutory mandate.

The current conflict among the circuits makes it impossible for GAO to carry out its responsibility of exercising supervision and control over the negotiation of contracts in an effective and uniform manner nationwide. For these reasons and the reasons set forth in our petition, this Court should address the issue left unresolved by the disposition of *Bristol Laboratories*.

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[4]The Merck contracts had a total price of more than $2.8 million (Pet. 3); the contracts involved in *Bristol Laboratories* had a total price of approximately $2 million (80-264 Pet. 3); the contracts involved in *SmithKline Corp.* had a total price of approximately $3.3 million (80-434 Br. in Opp. 1); the contracts involved in *Eli Lilly & Co.* had a total price of approximately $6 million (574 F. 2d at 920); the contracts involved in *Abbott Laboratories* had a total price of approximately $500,000 (C. A. App. at B-39).

It is therefore respectfully submitted that the the petition for a writ of certiorari should be granted.

REX E. LEE
Solicitor General

MARCH 1982

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Petitioner's Brief

Nos. 81-1273 and 81-1472

In the Supreme Court of the United States

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BRIEF FOR THE PETITIONERS IN No. 81-1273

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QUESTIONS PRESENTED *

1. Whether, with respect to negotiated government contracts, the Comptroller General's statutory and contractual access-to-records authority includes access to records of costs that the contractor does not allocate but that are defrayed by the contractor from commingled general revenues that include the government's payments under the contract.

2. Whether the Comptroller General's statutory and contractual access-to-records authority is limited exclusively to cost-based contracts.

3. Whether the Comptroller General's statutory and contractual access-to-records authority may be defeated by a claim that review of government procurement methods is an unauthorized purpose for exercising such authority.

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* The first question is the only one raised in No. 81-1273 and is therefore the only question discussed in this brief. Questions 2 and 3 are raised in the cross-petition, No. 81-1472, and will be addressed in the government's Brief for the Respondents in No. 81-1472.

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In the Supreme Court of the United States

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BRIEF FOR THE PETITIONERS IN No. 81-1273

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-32a)[1] is reported at 665 F.2d 1236. The opinion of the district court (Pet. App. 35a-40a) is not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 33a-34a) was entered on September 10, 1981. On December 4, 1981, the Chief Justice extended the time for filing a petition for a writ of certiorari to and including January 8, 1982. The petition for a writ of certiorari in No. 81-1273 was filed on January 7, 1982. The conditional cross-petition in No. 81-1472 was filed on February 5, 1982. Both petitions were granted, and the cases consolidated, on April 19, 1982 (J.A. 5a). See note *, *supra*. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

1. 10 U.S.C. 2313(b) provides:

> Except as provided in subsection (c), each contract negotiated under this chapter shall provide that the Comptroller General and his representatives are entitled, until the expiration of three years after final payment, to examine any books, documents, papers, or records of the contractor, or any of his subcontractors, that directly pertain to, and involve transactions relating to, the contract or subcontract.

2. 41 U.S.C. 254(c) provides:

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[1] "Pet. App." refers to the appendix to the petition in No. 81-1273. "C.A. App." refers to the joint appendix filed in the court of appeals.

All contracts negotiated without advertising pursuant to authority contained in this Act shall include a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall until the expiration of three years after final payment have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors engaged in the performance of and involving transactions related to such contracts or subcontracts. Under regulations to be prescribed by the Administrator, however, such clause may be omitted from contracts with foreign contractors or foreign subcontractors if the agency head determines, with the concurrence of the Comptroller General of the United States or his designee, that the omission will serve the best interests of the United States. However, the concurrence of the Comptroller General of the United States or his designee is not required for the omission of such clause—

(1) where the contractor or subcontractor is a foreign government or agency thereof or is precluded by the laws of the country involved from making its books, documents, papers, or records available for examination; and

(2) where the agency head determines, after taking into account the price and availability of the property or services from United States sources, that the public interest would be best served by the omission of the clause.

If the clause is omitted based on a determination under clause (2), a written report shall be furnished to the Congress. The power of the agency head to make the determination specified in the preceding sentences shall not be delegable.

STATEMENT

1. The government is, and has been for many years, a major purchaser of pharmaceuticals. Annual federal expenditures for pharmaceuticals exceed one billion dollars (Pet. App. 25a).[2] Among the companies from whom these products are purchased is respondent Merck & Co., Inc. (Merck). In 1973 Merck entered into three contracts with the Defense Supply Agency of the Department of Defense and one contract with the Veterans Administration for the sale of pharmaceutical products to the government.[3] All four contracts were awarded without formal advertising (C.A. App. 35-37) and all were negotiated fixed-price contracts.[4] The aggregate purchase price of the contracts totalled more than $2.8 million (Pet. App. 25a; C.A. App. 34-37). Moreover, as required by 10 U.S.C. 2313(b)[5] and 41 U.S.C.

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[2] In fiscal year 1973 the federal government's expenditures and reimbursements for prescription drugs aggregated $1.6 billion, including approximately $252 million in direct purchases and more than $1.3 billion in reimbursements under federally sponsored health programs (including costs of drug dispensing) (J.A. 130a). The total for fiscal year 1973 exceeded by more than $500 million the aggregate federal drug expenditures for fiscal year 1970 (*ibid.*).

[3] The contracts involved the following products: Diuril, Monovalent flu vaccine, Benemid, and Aldomet (J.A. 7a).

[4] A negotiated government contract is a method of procurement authorized by statute to be used in situations in which the formal public advertising and bidding procedure is deemed impractical or unnecessary. See 10 U.S.C. 2304(a); 41 U.S.C. 252(c).

[5] See page 2, *supra*. This provision is applicable to the Defense Supply Agency contracts.

254(c),[6] each of the contracts contained a standard access-to-records provision in which Merck agreed that "the Comptroller General of the United States * * * shall * * * have access to and the right to examine any directly pertinent * * * records of the Contractor * * * involving transactions related to this contract" (Pet. App. 2a; J.A. 12a-14a).

Pursuant to these statutory and contractual provisions, the Comptroller General, by letter of August 26, 1974, made a timely request of Merck for access to designated records. The Comptroller General explained that the request was part of "a review of the procurement of drugs by agencies of the Federal Government, including the pricing of drugs and pharmaceuticals procured under negotiated contracts" (J.A. 17a). To that end, the Comptroller General sought to examine (*id.* at 18a):

> all books, documents, papers, and other records directly pertinent to the contracts, which include, but are not limited to (1) records of experienced costs including costs of direct materials, direct labor, overhead, and other pertinent corporate costs, (2) support for prices charged to the Government, and (3) such other information as may be necessary for use to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government's interests.

2. Respondent refused to comply with the Comptroller General's request. Instead, on October 2, 1974, it commenced the present action in the United States District Court for the District of Columbia seeking declaratory and injunctive relief to bar the General

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[6] See pages 2-3, *supra*. This provision is applicable to the Veterans Administration contract.

Accounting Office (GAO) from access to its records (J.A. 6a-9a). The United States subsequently intervened in the action and filed a counterclaim to require respondent to allow the requested inspection (J.A. 10a-16a).

Following discovery, the district court on August 12, 1977, granted in part and denied in part each party's motion for summary judgment (Pet. App. 35a-40a). The court rejected Merck's arguments that the Comptroller General's request was based on the assertedly improper purpose of "conduct[ing] an economic survey of the pharmaceutical industry" rather than the concededly proper purpose of "ensur[ing] that the prices [the government] pays are reasonable and appropriate" (*id.* at 36a), and that no cost records were subject to disclosure because "the contract prices were not cost based" (*ibid.*). Instead, relying principally on *Hewlett-Packard Co.* v. *United States*, 385 F.2d 1013 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968), the court held that GAO examination of records for non-cost-based contracts "accommodates [the] governmental interest in supervising and controlling the procurement process in precisely the manner intended by Congress * * * [and] that the survey proposed by the Comptroller in this case * * * will facilitate supervision of the procurement process and is within his authority" (Pet. App. 38a). Accordingly, the court declined to follow "the restrictive approach to [the] access-to-records clauses taken" (*ibid.*) by the district court in *Eli Lilly & Co.* v. *Staats*, a decision that was later reversed by the Seventh Circuit. See 574 F.2d 904 (7th Cir.), cert. denied, 439 U.S. 959 (1978).

With respect to the scope of access, however, the district court held (Pet. App. 38a-40a) that access should be limited to records of manufacturing and

delivery costs in accordance with the district court's decision in *Bristol Laboratories* v. *Staats*, 428 F. Supp. 1388 (S.D.N.Y. 1977), aff'd, 620 F.2d 17 (2d Cir. 1980), aff'd by an equally divided court, 451 U.S. 400 (1981). On this ground, the court denied GAO access to all records of respondent's unallocated costs of research and development, marketing and promotion, distribution, and administration (Pet. App. 40a).

Pursuant to its opinion, the court ordered (Pet. App. 39a-40a):[7]

> that the Comptroller General of the United States and his duly authorized representatives have the right to examine all books, documents, papers, or records directly pertaining to the pricing and cost of producing the items furnished by [respondent] under the following contracts * * *, including manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision), manufacturing overhead (including plant administration, production planning, warehousing, utilities and security), royalty expenses, and delivery costs; and it is
>
> FURTHER ORDERED, that defendant Comptroller General shall not demand access to books, documents, papers, or records with respect to research and development, marketing and promotion, distribution, and administration (except

[7] On respondent's motion to alter or amend the judgment, the district court entered a revised judgment on January 24, 1979 (Pet. App. 41a-44a). Among other things, the revised judgment added provisions to protect the confidentiality of records produced by Merck pursuant to GAO's request, but it did not alter the scope of access afforded GAO by the initial order (*id.* at 42a).

> to the extent such data may be included in the cost items listed above) * * *.

3. Both sides appealed to the United States Court of Appeals for the District of Columbia Circuit. During the pendency of these appeals, this Court granted the government's petition for a writ of certiorari in *Staats* v. *Bristol Laboratories*, *supra*. The court of appeals, accordingly, deferred decision in this case pending disposition of *Bristol Laboratories*.[8] On April 29, 1981, this Court affirmed the Second Circuit's judgment in *Bristol Laboratories*, by an equally divided Court (Justice Stewart not participating) (451 U.S. 400).

Following this Court's action in *Bristol Laboratories*, a divided panel of the District of Columbia Circuit affirmed the district court's judgment in this case (Pet. App. 1a-32a). The panel majority, in a brief per curiam opinion, noted the conflicting decisions among the lower courts on the issues presented and observed that "[c]onflicts in those decisions must be resolved by the Supreme Court, not by us" (*id.* at 3a):

> Accordingly, without more, we affirm the judgment of the District Court filed January 24, 1979, pursuant to the District Court's memorandum opinion filed August 12, 1977.

Judge Mikva dissented in part.[9] Not content with the majority's summary disposition, Judge Mikva

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[8] While the appeals in this case were pending in the court of appeals, Merck filed a conditional petition for a writ of certiorari before judgment. The petition was denied on December 8, 1980. 449 U.S. 1038.

[9] Judge Mikva concurred in the judgment to the extent that it affirmed the district court's order granting the Comptroller General access to Merck's records of allocated costs.

expressed the view that "we must fulfill our obligation to provide guidance on this issue until the Supreme Court has spoken * * *" (Pet. App. 4a). In a thorough and detailed opinion, he concluded that "Congress intended to give the Comptroller General exactly the sort of authority he seeks to exert here" (*ibid.*). Agreeing with the Seventh Circuit's holding in *Eli Lilly & Co.* v. *Staats, supra*, and citing relevant legislative history, Judge Mikva stated that "[t]he test of 'directly pertinent' "—the term that defines the scope of the Comptroller General's access rights—is "whether [the] documents will assist the government to determine whether its negotiating practices sufficiently protect it from wasteful, fraudulent, or inefficient procurement practices" (Pet. App. 30a). Under this test, Judge Mikva continued, "there is absolutely no legally compelling basis on which to conclude that such access extends to the manufacturing but not to the research and development costs of pharmaceutical companies such as Merck" (*id.* at 32a).

SUMMARY OF ARGUMENT

This case involves an effort by the Comptroller General to evaluate government procurement practices for its annual purchases of hundreds of millions of dollars of pharmaceuticals. These enormous expenditures are made in the context of an industry in which return on net worth has been calculated as twice the average for all manufacturing companies and return on sales as three times the national average (J.A. 131a). In order to determine whether the government's methods for purchasing pharmaceuticals have resulted in wastefulness, the Comptroller General has invoked his statutory authority to review documents of government contractors necessary for that purpose. To date, this effort has been frus-

trated by the opposition of drug companies from whom records were requested and by judicial decisions that afford a right of access so severely restricted as to be virtually meaningless.

The General Accounting Office is charged by Congress with the responsibility to "investigate * * * all matters relating to the receipt, disbursement, and application of public funds * * * [and to] make recommendations looking to greater economy or efficiency in public expenditures." 31 U.S.C. 53(a). Pursuant to 10 U.S.C. 2313(b) and 41 U.S.C. 254(c), the Comptroller General is entitled to have access to, and to examine, the books and records of a government contractor that are directly pertinent to the contract and involve transactions relating thereto. Respondent contends that this statutory and contractual right does not extend to records pertaining to unallocated costs of research and development, advertising and promotion, distribution, and administration, despite the fact that the government's payments are used to defray these expenses. Neither the statute nor its legislative history provides support for such an exemption from GAO's right of access.

Although negotiated contracts are not the preferred mechanism for government procurement, Congress has recognized that, as a practical matter, certain goods or services cannot efficiently be obtained by any other means. Thus, negotiated contracts are permitted in certain circumstances, but are subject by statute to enhanced supervisory vigilance. In particular, Sections 2313(b) and 254(c) are premised on Congress' determination that "negotiated contracts * * * require close supervision and control * * *." H.R. Rep. No. 791, 82d Cong., 1st Sess. 2 (1951).

Representative Hardy, the sponsor of the legislation and chairman of the subcommittee that considered the bill, explained that examination of contractors' records by the Comptroller General would allow "the General Accounting Office to look behind the * * * [price] which had been established * * * [to assess whether it was] excessive" and would act as a "safeguard against waste and extravagance" in government procurement. 97 Cong. Rec. 13198 (1951). Because of its concern that "there is every chance in the world that the Government will come out on the short end of the deal," Congress enacted the access-to-records statutes to "enable the * * * [Comptroller General] to check the transaction, both from the Government records and the contractors' books" (*ibid.*) (remarks of Rep. Hardy). And, in light of GAO's responsibility to investigate and make recommendations regarding economy and efficiency in public expenditures, Congress intended that "the Comptroller General [be given] the proper tools to do the job the Congress has instructed him to do" and that, "if * * * [GAO] should find that the * * * [price was] excessive, it could, and undoubtedly would, bring the facts to the attention of the contracting officer, and possibly in an extreme case, it might call attention of the Congress to the situation" (*ibid.*) (remarks of Rep. Hardy).

Moreover, GAO has consistently construed the access-to-records statutes to authorize examination of all cost records relating to the reasonableness of the contract price. On several occasions GAO has presented this interpretation to Congress, which has never indicated its disapproval.

In light of the language, legislative history, and evident purpose of the access-to-records provisions,

the Comptroller General must be allowed to examine all of the contractor's cost records that are necessary and appropriate to determine whether the price charged the government was "extravagan[t]," "excessive," or "wasteful[]" (97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy)). Applying this standard to the present case, it is clear that the Comptroller General is entitled to access to respondent's cost records pertaining to research and development, advertising and promotion, distribution, and administration.

The court below denied access by GAO to records of costs that respondent neither allocates to particular products or contracts nor calculates on a product basis in setting prices. The court has thus created an exemption neither expressed in the statutes nor intended by Congress. This restriction is, moreover, not justifiable for any reasons relating to accounting. No generally accepted accounting principle requires respondent to allocate its costs, nor, for that matter, is respondent required to maintain its unallocated system of cost accounting. Accordingly, respondent is afforded substantial latitude in its choice of financial reporting methods. But, in exercising its statutory and contractual rights to records access, the government cannot be bound by the accounting method respondent has selected for its own purposes. If Merck had fully allocated its costs, GAO's right to conduct an inspection adequate to evaluate the reasonableness of the contract price would be clear, and no different outcome is warranted simply because respondent has chosen to allocate only some of its costs.

Merck's unilateral election to keep its business records on the basis of unallocated costs cannot obscure the fact that an examination of those costs is

necessary for the Comptroller General to fulfill his statutory function of determining whether the government has implemented the most efficient method of procurement or has been charged a reasonable price. In this case, it is undisputed that Merck uses the payments by the government under the contracts at issue as part of commingled general revenues that help defray its unallocated expenses. Hence, Merck's unallocated costs are critical to an assessment of the fairness of the contract price and the advisability of continued adherence by the government to the negotiated procurement methods employed here. Especially where, as in the pharmaceutical industry, direct manufacturing and delivery costs constitute only about 9% of a product's sale price, and manufacturers expend approximately 12% of sales revenues on research and development, it would completely frustrate GAO's inquiry into the appropriateness of the methods used to procure pharmaceuticals to limit its examination to allocated costs such as production and delivery and to exclude the far more significant unallocated costs such as research and development, advertising and promotion, distribution, and administration.

For these reasons, the middle ground carved out by the court of appeals—permitting access to allocated costs but not to unallocated costs—is an unsupportable limitation on GAO's investigative authority that cannot be reconciled with the intent of Congress. In the context of the pharmaceutical industry, it would deprive the Comptroller General of access to essential information on the vast majority of respondent's costs and, as a result, would cripple GAO's exercise of its statutory mandate. The Court should not construe the statutory provisions "in a manner which runs

counter to the broad goals which Congress intended it to effectuate" (*FTC* v. *Fred Meyer, Inc.*, 390 U.S. 341, 349 (1968)).

ARGUMENT

THE ACCESS-TO-RECORDS PROVISIONS AUTHORIZE THE COMPTROLLER GENERAL TO EXAMINE A CONTRACTOR'S BOOKS AND RECORDS PERTAINING TO UNALLOCATED COSTS DEFRAYED FROM COMMINGLED GENERAL REVENUES THAT INCLUDE THE GOVERNMENT'S PAYMENTS UNDER THE CONTRACT

A. Introduction

As head of the General Accounting Office (GAO),[10] the Comptroller General is required to "investigate * * * all matters relating to the receipt, disbursement, and application of public funds" and to "make recommendations [to Congress] looking to greater economy or efficiency in public expenditures" (31 U.S.C. 53(a)). In addition, "[t]he Comptroller General is authorized and directed to make an expendi-

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[10] The General Accounting Office (GAO) is "an independent agency within the legislative branch of the Government." I R. Nash & J. Cibinic, *Federal Procurement Law* 19 (3d ed. 1977). See also Cibinic & Lasken, *The Comptroller General and Government Contracts*, 38 Geo. Wash. L. Rev. 349, 349 & nn.2, 3 (1970). The GAO was established by the Budget and Accounting Act of 1921, Section 301, 31 U.S.C. 41. The GAO is "independent of the executive departments and under the control and direction of the Comptroller General of the United States" (31 U.S.C. 41), who is "appointed by the President with the advice and consent of the Senate" (31 U.S.C. 42) and serves for a term of 15 years subject to removal for cause "at any time by joint resolution of Congress" (31 U.S.C. 43). See also 5 U.S.C. 902; 31 U.S.C. 65(d).

ture analysis of each agency in the executive branch of the Government * * * which * * * will enable Congress to determine whether public funds have been economically and efficiently administered and expended" (31 U.S.C. 60). See also 31 U.S.C. 65(a) ("[t]he accounting of the Government [shall] provide * * * effective control over income, expenditures, funds, property, and other assets").

The access-to-records provisions at issue in this case—10 U.S.C. 2313(b) and 41 U.S.C. 254(c)—complement the foregoing statutes and specifically contemplate GAO review of contractors' books and records. See Cibinic & Lasken, *The Comptroller General and Government Contracts*, 38 Geo. Wash. L. Rev. 349, 388 (1970). By the express terms of Sections 2313(b) and 254(c), all government contracts negotiated pursuant to designated statutory authority must provide that the Comptroller General shall have access to, and be entitled to examine, the books and records of the contractor that are directly pertinent to the contract and involve transactions relating thereto. Pet. App. 35a. See *United States* v. *Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979); *Eli Lilly & Co.* v. *Staats*, 574 F.2d 904, 912-916 (7th Cir.), cert. denied, 439 U.S. 959 (1978); *Hewlett-Packard Co.* v. *United States*, 385 F.2d 1013, 1016 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968); *SmithKline Corp.* v. *Staats*, 483 F. Supp. 712, 722 (E.D. Pa. 1980), vacated and remanded, 668 F.2d 201 (3d Cir. 1981), petition for cert. pending, No. 81-2082 (filed May 10, 1982).

Merck contends, however, that because the prices in its pharmaceutical contracts with the government

are not cost-based [11] and because its internal accounting system fails to allocate the vast majority of incurred costs to specific contracts, the statutory and contractual access provisions therefore do not extend to records pertaining to its unallocated costs of research and development, advertising and promotion, distribution, and administration. This claim is made despite the undisputed fact that these unallocated costs are defrayed from total revenues that include the government's payments under the contracts (J.A. 69a-70a). In summarily sustaining Merck's position, the court of appeals failed to consider the purpose and legislative history of the statutory provisions; the court also refused to defer to GAO's longstanding and consistent interpretation of those provisions, which has been recognized and left undisturbed by Congress. Contrary to the court of appeals' ruling, Merck's construction is inconsistent with the statutes and, if adopted by this Court, would severely hinder the Comptroller General's authority to promote sound government procurement practices. Indeed, in this case, because unallocated costs represent the most significant portion of the price of pharmaceuticals sold to the government, the decision below would render meaningless the Comptroller General's right of access and would totally defeat his statutory responsibilities to supervise the awarding of negotiated

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[11] The court of appeals, in a decision consistent with the ruling of every other circuit that has considered the issues, rejected Merck's contentions that the records access provisions are inapplicable here because its contracts with the government are not cost-based and because the Comptroller General sought access for an allegedly improper purpose. As noted above (see note *, *supra*), we address these issues in the government's Brief for the Respondents in No. 81-1472.

contracts and to evaluate the fairness of the contract price.

B. GAO's Interpretation Is Consistent With The Language and Legislative History Of The Access-To-Records Statutes And Furthers The Congressional Purpose

In an effort to fulfill a legislative mandate that requires him to "investigate * * * all matters relating to the receipt, disbursement, and application of public funds" (31 U.S.C. 53(a)), the Comptroller General seeks in this case to implement the statutory and contractual provisions authorizing access to records of government contractors. Congress has invested the Comptroller General with specific authority "to examine any books, documents, papers, or records of the contractor * * * that directly pertain to, and involve transactions relating to, the contract * * *" (10 U.S.C. 2313(b)). In contrast to the holding of the court of appeals, this language contains no exclusion of records relating to costs that a contractor chooses not to allocate; rather, it is a broad grant of investigative authority that permits access to records necessary for the Comptroller General to fulfill his supervisory responsibilities over public expenditures. Merck does not dispute that it uses the payments by the government under the contracts at issue to help defray its unallocated expenses. Records of those expenses therefore "directly pertain" to the government's contracts.

The limitations engrafted by the court of appeals on to the plain language of the records access statutes have no basis in their legislative history, which makes clear that Congress intended the Comptroller General to have a broad right of access in order to determine the reasonableness of the contract price and the ade-

quacy of the protection afforded the government in negotiated procurements. The access statutes were enacted in 1951 as amendments to the Armed Services Procurement Act of 1947, ch. 65, 62 Stat. 21 *et seq.*, and the Federal Property and Administrative Services Act of 1949, ch. 288, 63 Stat. 377 *et seq.* See Act of Oct. 31, 1951, ch. 652, 65 Stat. 700.[12] Because negotiated contracts lack the competitive safeguards inherent in advertised procurements, Congress recognized that "negotiated contracts * * * require close supervision and control * * *." H.R. Rep. No. 791, 82d Cong., 1st Sess. 2 (1951); S. Rep. No. 603, 82d Cong., 1st Sess. 2 (1951). Thus, Congress imposed a system of checks and controls designed to enhance the fiscal integrity of the negotiation process; among these controls were the access-to-records provisions. Representative Hardy, the sponsor of the legislation and chairman of the subcommittee that considered the bill, explained that examination of contractors' records by the Comptroller General would enable "the General Accounting Office to look behind the * * * [price] which had been established * * * [to assess whether it was] excessive" and would act as a "safeguard against waste and extravagance" in government procurement. 97 Cong. Rec. 13198 (1951). See also *id.* at 13373 (remarks of Rep. Hoffman) ("GAO is * * * the most effective agency we have against fraud and extravagance and waste and all those things"); (*ibid.*) (remarks of Rep. Church)

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[12] As originally enacted, the two statutory provisions were identical. Although the language of 10 U.S.C. 2313(b) was slightly altered in a subsequent recodification, no change of substance was intended. See Act of Aug. 10, 1956, ch. 1041, Section 49(a), 70A Stat. 640; 102 Cong. Rec. 13952 (1956) (statement of Sen. O'Mahoney).

(legislation "is necessary in the interest of integrity or economy"). As Representative Hardy emphasized:

> The major purposes of the bill are twofold: One, to give the Comptroller General the proper tools to do the job the Congress has instructed him to do; and, two, to provide a deterrent to improprieties and wastefulness in the negotiation of contracts.

Id. at 13198; see also *id.* at 13200 (remarks of Rep. Hardy).

Because of its concern that, "aside from any intentional liberality on the part of the Government contracting officer, there is every chance in the world that the Government will come out on the short end of the deal," Congress sought to "enable the * * * [Comptroller General] to check the transaction, both from the Government records and the contractors' books" (*id.* at 13198) (remarks of Rep. Hardy). See also *id.* at 13377 (remarks of Rep. Hoffman and Rep. Hardy). And, in accordance with the Comptroller General's responsibility to investigate and make recommendations regarding economy and efficiency in public expenditures (see page 14, *supra*), Congress fully expected that "if * * * [GAO] should find that the * * * [price was] excessive, it could, and undoubtedly would, bring the facts to the attention of the contracting officer, and possibly in an extreme case, it might call attention of the Congress to the situation" (*id.* at 13198 (remarks of Rep. Hardy)).[13]

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[13] See also H.R. Rep. No. 791, *supra*, at 5 (GAO letter stating that "any abuses discovered by the General Accounting Office in exercising the authority contained [in the bill] promptly will be brought to the attention of the proper officials, and, if warranted, to the attention of the Congress"); S. Rep. No. 603, *supra*, at 4 (same).

In passing this legislation, Congress also was well aware of the broad authority it was conferring upon the Comptroller General. For example, Representative Hoffman stated that "[t]he GAO under this bill can go into the books * * * and get * * * anything and everything they want * * *" (97 Cong. Rec. 13373 (1951)). Similarly, Representative Harvey noted that a contractor "would be subject to having all of his books opened up for inspection by Government officials" (*id.* at 13372). Indeed, in introducing an amendment to exempt certain suppliers of materials, Representative Harvey objected to the expansive terms of the Hardy bill (*id.* at 13376):

> Some little contractor or manufacturer who may be using only 10 percent of his capacity for the production of goods for the prime contractor, but because of that—and he cannot afford to keep a separate set of books for that 10 percent —it means that every section of his books will have to come under the complete scrutiny of the GAO. He is going to be harassed no end to try to break down production costs and show the details on that 10 percent of his production that went into the general program of defense. While I credit the author of the bill with the very best of intentions, I do not think he understands or fully appreciates what the ultimate effect will be upon our economy if every person who is manufacturing anything is going to have to supply all the answers to the GAO on everything that he manufactures, and such is literally going to be the impact of the bill if this amendment is not included.

Representative Hill reiterated this concern, arguing that GAO could "come out to that little town and examine all of his books because he happens to be

making a few pieces of equipment for a subcontractor in New York City" (*ibid.*). Representative Hoffman also supported adoption of the amendment because "[i]f someone out in the country makes a contract for * * * an item which may be 10 percent of the total production, * * * under this bill, if it goes through [without the amendment], the GAO can send someone out there and go through the books, not only with reference to that one item of 10 percent which went into production for the Government, but into all of his other business where that same item was used" (*id.* at 13377). However, Representative Hardy opposed the amendment on the ground that it "would make it impossible frequently to obtain information which would be vital in a study of a contract" (*id.* at 13376). The Harvey amendment was defeated (*id.* at 13377).

We recognize that Representative Hardy's bill did not originally contain the provision that records examined by GAO be "directly" pertinent to a government contract. The word "directly" was added as a floor amendment offered by Representative Hoffman and must be viewed, as Judge Mikva observed (Pet. App. 28a), in light of Representative Hoffman's understanding of the bill. In addition to the comments quoted above relating to the defeated Harvey amendment, Representative Hoffman explained that the inclusion of the word "directly" was intended to "limit the 'snooping' that may be carried on under this bill *which we do not have the votes to defeat.*" 97 Cong. Rec. 13377 (1951) (emphasis added). Representative Hardy did not object to this modification, which passed without debate or discussion (*ibid.*). In these circumstances, and especially given Representative Hardy's earlier opposition to the Harvey amendment and his belief that "those with nothing to hide have

nothing to fear by opening their books to the General Accounting Office" (*id.* at 13197), there is no reasonable basis for concluding that the Hoffman modification significantly altered the scope of the Hardy bill or was intended to bar the Comptroller General's access to records legitimately needed, as in this case, to protect against waste, excessive prices, and ineffective procurement. See Pet. App. 28a-30a (Mikva, J., dissenting); *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 916 & n.8. See also Comment, *The Comptroller General's Authority to Examine the Private Business Records of Government Contractors: Eli Lilly & Co.* v. *Staats*, 92 Harv. L. Rev. 1148, 1157-1158 (1979) ("[t]he court [in *Eli Lilly*] correctly rejected Lilly's argument that the insertion of the word 'directly' into the 'directly pertinent' formula sharply narrowed the scope of inquiry to be allowed the GAO").

Prior to the district court's decision in *Bristol Laboratories* v. *Staats*, *supra*, the courts of appeals had broadly construed the access-to-records provisions to effectuate the congressional intent to enable GAO to detect government inefficiency or wastefulness and to recommend improvements in the system of negotiated contracts. As the Ninth Circuit explained in *Hewlett-Packard Co.* v. *United States*, *supra*, the Comptroller General is empowered to investigate whether a contractor's costs are "out of line with the contract price" and hence whether "the contract may have been an inappropriate means of meeting this particular procurement need of the Government. While this appraisal could not affect these particular contracts, it could lead to the use of other methods of meeting future procurement needs" (385 F.2d at

1016).[14] Similarly, in *Eli Lilly & Co.* v. *Staats*, *supra*, the Seventh Circuit followed "the broad reading of *Hewlett-Packard* * * * [as] most consistent with the plain meaning of the statutory language and with the legislative history" (574 F.2d at 913) and concluded that Congress envisioned "an inquiry [by the Comptroller General] into whether costs are excessive" (*id.* at 915).[15]

Commentators have likewise recognized the broad remedial purpose of the access-to-records provisions. As Professor Mosher explained:

> The GAO audits a very limited sample of contracts annually, primarily to identify and evaluate the efficiency and effectiveness of procurement policy, pricing, controls, and auditing. Its focus is not upon individual contracts or contractors but upon the effectiveness of the systems and criteria whereby contracts are negotiated, car-

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[14] In *Hewlett-Packard*, GAO "requested all books, documents, papers or records * * * 'relating to the pricing and cost of performance, support for prices charged to the Government, and such other necessary information which would permit * * * [GAO] to review the reasonableness of the contract prices * * *'" (385 F.2d at 1015). The district court granted the government's motion for summary judgment "and entered a judgment substantially as prayed for in the complaint" (385 F.2d at 1013-1014), declaring that GAO "could examine any such records 'relating to the cost of producing the items furnished by Hewlett-Packard Company under the aforesaid contracts, including costs of direct material, direct labor and overhead costs * * *'" (385 F.2d at 1016). The court of appeals affirmed.

[15] The Seventh Circuit's analysis of the congressional purpose underlying the access-to-records statutes is discussed with approval in Comment, *supra*, 92 Harv. L. Rev. at 1157-1158 & nn.67, 68.

> ried out, and audited by the executive agencies. Its aims are primarily to develop and make recommendations for improvements in the process, not to seek out individual culprits.

See F. Mosher, *The GAO: The Quest for Accountability in American Government* 318 (1979). See also, *e.g.*, G. Cuneo, *Government Contracts Handbook* 183 (3d printing 1964) ("GAO audits are basically a post-performance audit review, and are related to the responsibilities of the Comptroller General to keep Congress informed of the degree of efficiency with which the executive agencies perform their procurement functions involving the administration of appropriated funds"); I R. Nash & J. Cibinic, *Federal Procurement Law* 381 (3d ed. 1977) ("[i]n negotiated contracts, Congress has been continually concerned with the possibility that unreasonable prices will be paid"); Cibinic & Lasken, *supra*, 38 Geo. Wash. L. Rev. at 388 ("[n]ot to be overlooked is Congress' deep and abiding distrust of the negotiation process"). Furthermore, "[s]uch reports [by GAO to Congress based on the access-to-records provisions] can be very useful. They can and have sharpened the Government's negotiation practices." *Id.* at 389.

As this Court has observed, the "objective * * * [in construing a statute] is to ascertain the congressional intent and give effect to the legislative will." *Philbrook* v. *Glodgett*, 421 U.S. 707, 713 (1975). See also, *e.g.*, *Rose* v. *Lundy*, No. 80-846 (Mar. 3, 1982), slip op. 8 ("we must analyze the policies underlying the statutory provision to determine its proper scope"). And, of course, a court's " 'individual appraisal of the wisdom or unwisdom of a particular course consciously selected by the Congress is to be

put aside in the process of interpreting a statute. Once the meaning of an enactment is discerned * * * the judicial process comes to an end.'" *Rubin* v. *United States*, 449 U.S. 424, 431 n.8 (1981), quoting *TVA* v. *Hill*, 437 U.S. 153, 194 (1978). See also, *e.g.*, *Schweiker* v. *Hogan*, No. 81-213 (June 21, 1982), slip op. 17-19; *United States* v. *Rutherford*, 442 U.S. 544, 551 (1979). In ignoring the plain language and legislative history of the access-to-records statutes, the decision below impedes GAO's statutory responsibilities and defeats the intention of Congress.

C. GAO's Interpretation Of The Access-To-Records Provisions Is A Consistent And Longstanding Construction That Congress Has Recognized And Never Disapproved

From the time of their enactment in 1951, the access-to-records statutes consistently have been construed by GAO to authorize the examination of all cost records relating to the reasonableness of the contract price. Congress is well aware of this construction and has not disapproved the agency's interpretation or amended the statutes to reject that position.

Shortly after passage of the access-to-records provisions, the Comptroller General stated in a public decision that the statutes "were intended, among other things, to afford a means whereby the Congress could be informed of any excessive or unreasonable payments to contractors holding negotiated contracts * * *." 32 Comp. Gen. 277, 278 (1952). More than a decade later, the Comptroller General expressed the same view that

> the overall objective [of an audit] is to review the manner in which the contracted activities of Federal agencies are administered and to recom-

> mend, where appropriate, corrective or improvement actions deemed necessary or desirable to promote greater efficiency or economy in Federal expenditures. * * * The audit reports of the General Accounting Office are intended * * * to inform the Congress and/or the Federal agencies concerned on the results of audit work on procurement contracts * * * and to make recommendations, based on such work, leading to greater efficiency and economy in such expenditures.

United States General Accounting Office, *Audits of Government Contracts* 8-9, 16 (1966). See also *id.* at 19-20.

On numerous occasions GAO has presented its construction of the access-to-records statutes to Congress, which has never indicated its disapproval of the agency's position. For example, in the 1956 Annual Report to Congress under 31 U.S.C. 53(a), the Comptroller General explained that GAO "audits are designed to evaluate the manner in which agency representatives perform their respective functions relating to negotiated contracts, and include a review of the contractor's organization, procedures, and business methods for the purpose of evaluating the protection which has been afforded the Government's interests." *Annual Report of the Comptroller General of the United States for the Fiscal Year Ending June 30, 1956*, at 23. See also G. Cuneo, *supra*, at 184 & n.10.

In 1963, Robert Keller, General Counsel of GAO, appeared before a congressional subcommittee that was "concerned with the availability of cost data in negotiated contracts" and "the need for, or desirability of, recommending legislative action" in light of Hewlett-Packard's recent refusal to permit inspection

of its cost records pursuant to the access-to-records provisions. See *Hearings on Relation of Cost Data to Military Procurement Before the Subcomm. for Special Investigations of the House Comm. on Armed Services*, 88th Cong., 1st Sess. 2, 3 (1963). Focusing on "the relationship of cost data to procurement and to post audit review * * * [and on GAO's function] to make recommendations looking to greater economy and efficiency in public expenditures" (*id.* at 5), Mr. Keller testified that "[o]ur experience indicates the need for careful examination into the reasonableness of accepting catalog or other established prices for negotiated procurements, particularly where contractors have resisted requests by the procurement agencies for cost data to support price proposals and quotations" (*id.* at 8). Emphasizing the importance of "obtain[ing] reasonable assurance that the prices [the Government] contracted to pay were fair to the Government as well as to the supplier" (*id.* at 12) and of "evaluating the reasonableness of the prices quoted" (*id.* at 15), Mr. Keller explained GAO's construction of the access-to-records provisions (*id.* at 6, 10-11, 15; emphasis added):

> With the increased use of negotiated contracts for the purchase of supplies and equipment, the Congress, in order to assure that such supplies and equipment are obtained at reasonable prices, has provided that negotiated contracts shall include a clause giving the Comptroller General * * * the right to examine any pertinent books and records of the contractor * * * involving transactions related to * * * work under the contract.
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> * * * * * *
>
> It is our position that the contract clause and the statute give us the right to examine the

> cost records of the contractor and other pertinent data that relates to the items included in the contract, *in sufficient completeness and detail to permit us to determine the reasonableness of the negotiated prices.*
>
> We believe our position is supported by the language of 10 U.S.C. 2313(b) and the contract provision and, to an even greater extent, by the legislative history of the statute * * *.
>
> We believe, further, that our position is supported by the fact that our interpretation of the statute has been consistently applied since its enactment without objection by the Congress and, therefore, should be given the consideration normally accorded longstanding administrative interpretations of statutes.
>
> * * * * * *
>
> [I]f Hewlett-Packard is successful in preventing the General Accounting Office from obtaining access to its records relating to such negotiated contracts, the Government will be deprived of the most important means for examining into the reasonableness of contract prices.

And, with particular pertinence to the present case, Mr. Keller stated that GAO could "go beyond direct manufacturing costs" into such areas as "how research costs are allocated as between the Government contract and commercial business" (*id.* at 23). Representative Hardy, based on his "background of personal knowledge * * * [of] what congressional intent was at the time * * * [the statutes were] originally passed" (*id.* at 3), commented that Mr. Keller had "stated this case very well as to the necessity for having a contract provision permitting audits of negotiated contracts" (*id.* at 23).

Two years later, GAO again apprised Congress of its construction of the access-to-records provisions. Comptroller General Campbell testified (*Hearings on Comptroller General Reports to Congress on Audits of Defense Contracts Before the Subcomm. on Military Operations of the House Comm. on Government Operations*, 89th Cong., 1st Sess. 44 (1965) (emphasis added)) that these provisions:

> permit detailed examination of a contractor's records to insure the necessary degree of supervision and control. In other words, the clear intent of the statute is to provide for the examination by the General Accounting Office of such records of a contractor, *to such an extent as will permit a meaningful examination of the reasonableness of the prices charged to the Government.*

Mr. Campbell later reiterated GAO's position (*id.* at 45, 48; emphasis added):[16]

> [T]he contract clause and the statute on which the clause is based gives us the right to examine the cost records of the contractor and other pertinent data that relate to the items included in the contract, *in sufficient completeness and detail to permit us to examine into the reasonableness of the negotiated prices.* * * * The fact that, in [the] final analysis, we may not be able

[16] Comptroller General Campbell's statement was clearly understood by Mr. Charles I. Derr, Senior Vice President, Machinery & Allied Products Institute, who described GAO's position to be "that the statute should be construed as broadly as is necessary in order to permit [GAO] to determine whether contract prices are reasonable." *Hearings on Comptroller General Audits, supra*, at 513; see also *id.* at 503 (statement of William J. Healey, staff counsel to the Machinery & Allied Products Institute).

> to question the legality of particular contract transactions does not preclude our reporting to the Congress and to the responsible administrative agencies that such transactions are wasteful or extravagant or that a particular contract transaction illustrates the need for an improvement in existing procurement or management procedures.

And General Counsel Keller also stated the agency's view that "the Congress intended the General Accounting Office to examine the books and records of the contractor to make certain that the Government was getting a fair deal out of negotiated contracts" (*id.* at 147). See also *ibid.* (statement of Comptroller General Campbell) (if the contractor "had his records commingled * * * [GAO] would have to see everything," including records not otherwise covered by the access-to-records provisions).

In 1971, Congress was again advised of GAO's interpretation of the access-to-records provisions. Paul Shnitzer, Assistant General Counsel of GAO, testified that such access "is very good for the purpose of determining what costs the contractor actually incurred in the performance of the contract as compared to the contract price." *Hearings on Competitive Problems in the Drug Industry Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business*, 92d Cong., 1st Sess. 8018 (1971). Mr. Shnitzer then elaborated (*id.* at 8018-8019):

> What I am saying is, and we do have a case which ultimately went up as far as the Supreme Court, is that under our 1951 authority, the contract is required to include a provision which gives the GAO the right to examine records of costs, direct and indirect, generated in the per-

> formance of that contract. So if a contract is awarded to company A and it comes within the purview of this—it is a negotiated contract for, let us assume, $100,000—we would have a right then to go back and examine the records of company A—the cost records, direct and indirect, to determine how much it cost him to perform that contract * * *.

In light of this history, the court of appeals was plainly unwarranted in rejecting GAO's interpretation of the access-to-records provisions. See *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 915. The court failed to heed the " 'venerable principle that the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong * * *.' " *E.I. du Pont de Nemours & Co.* v. *Collins*, 432 U.S. 46, 54-55 (1977), quoting *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969). " 'To sustain * * * [the agency's] application of this statutory term, we need not find that its construction is the only reasonable one, or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings.' " *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965), quoting *Unemployment Commission* v. *Aragon*, 329 U.S. 143, 153 (1946). Rather, "[i]t is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute." *Investment Company Institute* v. *Camp*, 401 U.S. 617, 626-627 (1971). And this principle is particularly apt where, as in this case, there is a "longstanding and consistent administrative interpretation" (*Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978)) that " 'involves a contemporaneous construction of [the] statute by the

[persons] charged with the responsibility of setting its machinery in motion' " (*Andrus* v. *Shell Oil Co.*, 446 U.S. 657, 667-668 (1980), quoting *Norwegian Nitrogen Co.* v. *United States*, 288 U.S. 294, 315 (1933)).

Moreover, judicial deference is especially appropriate " 'when Congress has refused to alter the administrative construction' * * * [and] that construction accords with well-established congressional goals." *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248, 251 (1978), quoting *Red Lion Broadcasting Co.* v. *FCC*, *supra*, 395 U.S. at 381. "[O]nce an agency's statutory construction has been 'fully brought to the attention of the public and the Congress,' and the latter has not sought to alter that interpretation * * *, then presumably the legislative intent has been correctly discerned." *United States* v. *Rutherford*, *supra*, 442 U.S. at 554 n.10, quoting *Apex Hosiery Co.* v. *Leader*, 310 U.S. 469, 489 (1940). Here, "[i]n the * * * years during which [the agency] has consistently * * * [adhered to its position], Congress has never expressed its disapproval, and its silence in this regard suggests its consent to [the agency's] practice." *EEOC* v. *Associated Dry Goods Corp.*, 449 U.S. 590, 600 n.17 (1981).

D. The Access-To-Records Provisions Authorize The Comptroller General to Examine Respondent's Records Pertaining To Its Costs Of Research and Development, Advertising And Promotion, Distribution, And Administration

In light of the legislative history and consistent administrative interpretation of 10 U.S.C. 2313(b) and 41 U.S.C. 254(c), the access-to-records provisions should be construed to authorize the Comptroller Gen-

eral to examine all of a contractor's cost records that are necessary and appropriate to determine whether the price charged the government was "extravagan[t]" "excessive," or "wasteful[]." 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy). The restricted right of access fashioned by the court of appeals creates an exemption without statutory basis (see Pet. App. 20a; Mikva, J., dissenting). Moreover, the limitations imposed by the court below would seriously impair the Comptroller General's statutory responsibility to determine the reasonableness of the contract price and the adequacy of the protection afforded the government in negotiated procurements. It would also disrupt the carefully crafted equilibrium Congress intended to bring to the negotiation process when it enacted the records access statutes (see *id.* at 11a).

In the circumstances of this case, it is clear that the Comptroller General is entitled to inspect Merck's cost records pertaining to research and development, advertising and promotion, distribution, and administration. As the Seventh Circuit recognized in *Eli Lilly & Co.* v. *Staats*, *supra*, " 'it is hard to imagine anything more directly related to a contract than the cost of producing the items covered by it or the matters going into the makeup of the price' " (574 F.2d at 913). See also *Hewlett-Packard Co.* v. *United States*, *supra*, 385 F.2d at 1016. The court of appeals in *Eli Lilly* found that the records requested by GAO came well within the terms of the access-to-records provisions (574 F.2d at 914; footnote omitted):

> In response to plaintiff's argument that including these items would not give full effect to the limits on disclosure implied by the use of the word "directly," without disputing that "directness" is a difficult concept to define, it should be noted that costs such as research and develop-

> ment at the least appear to have a logical, causal and consequential relationship to a portion of the price of the products purchased by the Government. Further, contrary to plaintiff's contention, such costs are not "remote" within the established definitions of that term in relation to at least a portion of the price because their inclusion in the price of the product is not unforeseeable once the costs are incurred, nor is their impact on a part of the price significantly altered by any intervening cause.

This analysis accords with the purpose of the access-to-records statutes to determine whether the government "c[a]me out on the short end of the deal" (97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy)) and with GAO's consistent construction of the access provisions to allow an "examin[ation of] the cost records of the contractor * * * in sufficient completeness and detail to permit us to examine into the reasonableness of the negotiated prices" (*Hearings on Comptroller General Audits, supra*, at 45 (statement of Comptroller General Campbell)).[17]

Indeed, the records sought in this case are particularly important in the context of pharmaceutical contracts that cost the government hundreds of millions of dollars annually. Because there is no generally accepted accounting principle governing allocation of costs, companies have significant latitude in this aspect of their financial reporting. In the pharmaceutical industry the practice has developed to allocate an exceedingly small percentage of costs to individual products. As a result, the allocated costs have been estimated to constitute as little as 9% of the sale price of such products. See Pet. App. 24a-

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[17] See also Comment, *supra*, 92 Harv. L. Rev. at 1157-1158 & nn.67, 68.

25a (Mikva, J., dissenting); *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 913, citing Rucker, *Public Policy Considerations in the Pricing of Prescription Drugs in the United States*, 4 Int'l J. Health Services 171, 173 (1974).[18] See also *SmithKline Corp.* v. *Staats*, *supra*, 483 F. Supp. at 722. At the same time, the drug industry chooses not to allocate larger and economically more significant costs, such as research and development,[19] promotion, marketing and distribution, and administration. See Reekie, *Price and Quality Competition in the United States Drug Industry*, 26 J. Indus. Econ. 223, 235 (1978) ("innovative outlays [are] by far the largest forms of outlay in the drug industry; manufacturing and other short-run variable costs forming only a small proportion of total costs").

Viewed against this background, the decision below, by precluding access to information relating to a government contractor's substantial unallocated costs, impermissibly restrains GAO's ability to carry out its statutory mandate. Unless the judgment is

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[18] Mr. Rucker states (*ibid.*):

> The first major issue deals with the proportion of product price that is accounted for by direct manufacturing and distribution costs. Table 1, which presents data for nine important branded products marketed in the U.S.[,] shows a median of 91 per cent as the proportion of supplier's revenue consumed by indirect factors, such as research and development, promotion, general administrative expense, taxes, and profit. Thus we see that only a very small percentage of wholesale price represents the direct expense of making the pharmaceutical agent available for patient consumption.

[19] One study indicated that for some firms research and development costs approximate 150% of total investment in plant and equipment (J.A. 133a).

reversed, GAO's study of pharmaceutical procurement will be based on records relating to only a small fraction of the costs necessary to a proper review of the subject—the fairness of the contract price. Moreover, any recommendations forthcoming from that study will be hampered by the insufficiency of the data. Hence, as Judge Mikva recognized (Pet. App. 23a-24a), the court of appeals' attempt to "split the baby" between allocated and unallocated costs "effectively defeats the purpose of the access provision." As Judge Mikva explained (*id.* at 25; citations omitted):

> [Merck's] narrow reading of the clause defies reason. The four contracts involved here between Merck and the United States concerned the supply of pharmaceutical products for a total price of more than $2,800,000. If Merck's "direct costs" are only nine percent of this figure, and if Congress' grant of access is limited to direct costs, the lower court's decision precludes governmental access to cost data behind the remaining charges of $2,548,000. The implications of such a limited interpretation of the access clause become even more significant when one considers the extent of the federal government's contractual business with drug companies. Federal expenditures for pharmaceuticals exceed one billion dollars annually. The narrow reading of the district court, if generally followed, would preclude government access to data concerning the underlying costs of more than $900,000,000 in pharmaceutical purchases annually. It should be obvious that Merck's "indirect costs" are "directly pertinent" to procurement transactions concerning these government contracts, for otherwise the legislative purpose of reducing waste in government procurement would be undermined severely.

The "compromise" fashioned by the district court and affirmed by the court of appeals is based on several erroneous premises.[20] Paramount among these errors is the court's failure to recognize the necessity to review records of unallocated costs. As Judge Mikva noted, "[i]mprovement of procurement techniques is impossible if the government cannot get a fair idea of the industry with which it negotiates" (Pet. App. 24a). By barring access to records of the vast preponderance of Merck's costs, the decision below could perpetuate the inequality in bargaining that the statutes were designed to eliminate. Con-

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[20] It is clear that the district court, whose opinion the court of appeals expressly adopted (Pet. App. 3a), rejected GAO's position and substituted its own judgment of what is " 'responsible and reasonable' " and " 'a sensible point at which to draw the line' " (Pet. App. 38a, quoting *Bristol Laboratories* v. *Staats*, 428 F. Supp. at 1391). The line drawing that struck the district court in *Bristol* as "sensible" has no basis in either the statutory language or the legislative history; *it was derived solely from Bristol's description of documents it was willing to produce* (see *id.* at 1389-1391). The compromise fashioned by the district court in *Bristol* has never been subjected to reasoned analysis by any court that subsequently has applied its holding. The Second Circuit affirmed in *Bristol* "for the reasons given in" the district court opinion (620 F.2d at 18). Similar cursory treatment was accorded the issue by the district court and court of appeals in this case. In *SmithKline Corp.* v. *Staats*, *supra*, the Third Circuit "adopt[ed] the standard formulated in *Bristol*" (668 F.2d at 213) even though it recognized that its decision "may make it more difficult in some cases for GAO to obtain the information it may need to uncover wastefulness. Economic studies based on such restricted data may be of limited utility, and if the access provisions were meant to equalize the relationship between the Government and private contractors, our reading of the clause fails to advance fully that purpose * * *" (*ibid.*; footnote omitted).

versely, if GAO is given access to records of unallocated costs, it will be able to recommend methods of procurement best suited to the circumstances and most likely to reduce waste, precisely as Congress intended.

It is important to recognize that the designation "unallocated" is neither well defined nor immutable. The relevant costs are unallocated not because generally accepted accounting principles require that treatment or because they are incapable of reasonable allocation; they are not allocated simply because Merck chooses not to allocate them.[21] In fact, Merck occasionally makes allocations of some of the very same "unallocated" costs involved here on an "off books" basis for "internal management" purposes (J.A. 54a) and uses such allocations for "general information and trend data" (*id.* at 55a). See Pet. App. 31a & n.33. Moreover, similar allocations are commonly made in the context of government procurement. If the contracts in this case had been cost-based rather than fixed-price, respondent would be entitled to claim reimbursement for its indirect costs that were allocable to those contracts. There is no

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[21] The issue of cost allocation arises frequently in government procurement and has been addressed in regulations. For example, 41 C.F.R. 1-3.1220(b)(4), which is applicable to negotiated procurements (see 41 C.F.R. 1-3.000, 1-3.100), defines "allocate" to "include[] both direct assignment of cost and the reassignment of a share from an indirect cost pool." See also 41 C.F.R. 1-3.1220(b)(14) and (15), 1-15.202, 1-15.203 (definitions of "indirect cost" and "indirect cost pool"), 41 C.F.R. 1-15.205-35 (principles for allocating research and development costs to government contracts). Moreover, 41 C.F.R. 1-15.201-4 defines as a "cost * * * allocable to a Government contract" one that "[i]s necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown." 41 C.F.R. 1-15.201-4(c).

reason to conclude that the same approach is inapplicable where, as here, it is GAO that seeks to make the allocation in order to review the adequacy of the protection afforded the government's interest in negotiated procurement.

In any event, the government's exercise of its statutory authority cannot be bound by the accounting method Merck has established for its own purposes. See *Exxon Corp.* v. *Department of Revenue of Wisconsin*, 447 U.S. 207, 226 (1980). If Merck had fully allocated its costs, GAO's right to conduct an inspection adequate to evaluate the reasonableness of the contract price would be clear. Yet, the logical consequence of the court of appeals' decision is that respondent would not be obliged to open any of its books to the Comptroller General if, for internal bookkeeping purposes, it chose to allocate none of its costs to a particular contract or product.[22]

Furthermore, Merck's election to keep its business records on the basis of unallocated costs cannot obscure the fact that Merck uses the payments by the government under the contracts at issue, as part of commingled general revenues, to help defray its unallocated expenses (J.A. 69a-70a). Accordingly, re-

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[22] Merck contends that "[i]nformation obtained from one pharmaceutical company cannot be validly compared to that of other companies" (J.A. 35a). Indeed, different companies may use different methods for allocating costs. But rather than providing a principled basis for the decision below, this argument underscores the need to obtain full cost information. Precisely because internal accounting methods differ, GAO needs to view the broad picture in order to make a meaningful evaluation of the records it inspects. Under the court of appeals' decision, GAO will have access to records of a small fraction of Merck's costs without any basis for comparison to similar data that may be obtained from other pharmaceutical companies.

spondent's costs, even though unallocated, "directly pertain to * * * the [government's] contract" (10 U.S.C. 2313(b)) and are critical to an assessment of the fairness of the contract price and the advisability of continued adherence by the government to the negotiated procurement methods employed here. If respondent's total costs are substantially lower than the prices paid by the government, the Comptroller General may recommend that the Department of Defense and the Veterans Administration adopt different procurement practices in the future. Or, if Merck's costs reflect excessive duplication or waste, this, too, would be a significant factor in any changes in procurement methods GAO may recommend. See *Hewlett-Packard Co.* v. *United States*, *supra*, 385 F.2d at 1016 ("[w]hile this appraisal could not affect these particular contracts, it could lead to use of other methods of meeting future procurement needs").

For these reasons, the court of appeals' decision would effectively defeat the congressional objective to guard against waste, extravagance, and excessive pricing. And, as explained in *Eli Lilly & Co.* v. *Staats*, *supra*, "[t]he mere fact that, as [respondent] asserts, it does not or even could not allocate costs such as research and development to an individual contract does not undercut the proposition that those costs are directly pertinent to an individual contract but merely indicates that they are directly pertinent to more than one individual contract" (574 F.2d at 914). Especially in light of the cost structure in the pharmaceutical industry (see pages 34-35, *supra*), it is manifest that the Comptroller General's inquiry into the appropriateness of the contract price cannot be limited to allocated costs of production and delivery but must include such significant unallocated

costs as research and development, advertising and promotion, distribution, and administration. Respondent's contrary position would plainly thwart the congressional policy and would reduce the Comptroller General's exercise of his remedial authority to an empty and ineffectual endeavor. See Pet. App. 24a-31a (Mikva, J., dissenting); *SmithKline Corp.* v. *Staats, supra*, 668 F.2d at 213.[23] The Court should not, "in the absence of an unmistakable directive, construe the [records access statutes] in a manner which runs counter to the broad goals which Congress intended it to effectuate." *FTC* v. *Fred Meyer, Inc.*, 390 U.S. 341, 349 (1968). See also *Department of State* v. *Washington Post Co.*, No. 81-535 (May 17, 1982), slip op. 6-7; *Sunshine Anthracite Coal Co.* v. *Adkins*, 310 U.S. 381, 392 (1940).

The scope of access requested in this case is neither unique nor unreasonable. Indeed, it is no more expansive than disclosures a company can be, and often is, compelled to provide in discovery in civil litigation, or in response to governmental inquiries such as grand jury subpoenas, IRS summonses (see, *e.g.*, *United States* v. *Powell*, 379 U.S. 48 (1964)), and civil

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[23] Of course, insofar as respondent has allocated a given category of costs, the Comptroller General would be entitled to examine records relating only to such costs as have been attributed to the product supplied the government (together with records necessary to verify such data). To the extent that broader access is required in this case, it is the result of respondent's decision not to allocate its costs and the consequent need for the Comptroller General to construct a measure of those costs in order to determine the reasonableness of the contract price. Whatever the nature of a contractor's accounting system, the Comptroller General's authority remains the same—to examine those costs necessary to determine whether the contract price was "extravagan[t]," "excessive," or "wasteful[]." 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy).

investigative demands (see, *e.g.*, 15 U.S.C. (& Supp. IV) 1311 *et seq.*). *Cf. United States* v. *Morton Salt Co.*, 338 U.S. 632, 652 (1950); *Appeal of FTC Line of Business Report Litigation*, 595 F.2d 685, 696 (D.C. Cir.), cert. denied, 439 U.S. 958 (1978); *United States* v. *IBM*, 66 F.R.D. 186 (S.D.N.Y. 1974). These other disclosure devices apply to all companies whether or not they have any business dealings with the government. Government contractors such as Merck, however, stand on a different footing altogether, as Judge Mikva recognized (Pet. App. 27a) ("Merck did business with the government voluntarily, and thereby accepted the access clause as a precondition of doing business with the government").[24]

Finally, it is important to note that affording GAO the access it seeks in this case would not open the door to limitless intrusions on the private sector. As the Third Circuit noted in *SmithKline Corp.* v. *Staats*, *supra*, 668 F.2d at 214, Congress carefully restricted GAO's access to records, first, by limiting demands for access to within three years of final payment (see 10 U.S.C. 2313(b)) and, second, by limiting the applicability of the access provisions to negotiated (rather than advertised) contracts.[25] But

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[24] Moreover, because the district court has imposed stringent confidentiality provisions in its order (Pet. App. 42a-44a), any concern Merck may once have had about unauthorized disclosure is effectively eliminated.

[25] There are, in addition, certain practical limitations on access. GAO does not seek access here to all of Merck's corporate records, but only to those records relating to costs and prices. Moreover, as Judge Mikva observed, the government would not examine "costs recovered exclusively from non-governmental contracts" or unallocated costs that are "minimally relevant to government contracts" (Pet. App.

the courts are not empowered to add judicial modifications to these congressional limitations, such as those imposed below, that have no basis in the statutory language or legislative intent.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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JULY 1982

30a-31a). Of necessity, the parameters of these limitations would be defined in each case in consultation with the contractor, who is in a far better position than the Comptroller General to establish in the first instance the irrelevance or de minimis nature of particular data (see *id.* at 31a). In addition, certain items may require no more than random checks or routine verification rather than full-scale audits; but these determinations must be made after the process of inspection has begun and cannot occur if GAO is confined as the court below held.

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Respondent's Brief

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

CHARLES A. BOWSHER,
COMPTROLLER GENERAL OF THE UNITED STATES,
AND UNITED STATES OF AMERICA,
Petitioners,

v.

MERCK & CO., INC.

MERCK & CO., INC.,
Petitioner,

v.

CHARLES A. BOWSHER,
COMPTROLLER GENERAL OF THE UNITED STATES,
AND UNITED STATES OF AMERICA

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR MERCK & CO., INC.

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QUESTIONS PRESENTED

1. Whether the Comptroller General's statutory authority to examine records that "directly pertain to, and involve transactions relating to, the contract" affords access to all of a contractor's records of indirect costs for all of its products solely because those costs may be met by general corporate revenues that include the government's payment under a procurement contract.

2. Whether a contractor's records relating to its costs "directly pertain to, and involve transactions relating to, the contract," when the contract price is set without reference to the contractor's costs in accordance with procurement statutes that treat the price established in the commercial market as the fair price for products purchased by the government.

3. Whether the limited authority granted the Comptroller General to examine a contractor's records in order to audit individual procurement contracts may be employed to demand access to private corporate records for a different, unauthorized purpose.

AFFILIATED COMPANIES

Merck & Co., Inc.'s non-wholly-owned subsidiaries, set forth here in compliance with Rule 28.1, are:

Arramara Teoranta

Associated Pharmaceutical Products Limited

BAC Japan Co. Ltd.

Banjo Polymers, Inc.

Banyu Pharmaceuticals Co., Ltd.

Calgon Far East Co., Ltd.

Chemex, Inc.

Ferlux Labo S.A.

Ferlux S.A.

Kelp Industries Pty. Limited

Kiinteisto oy Irmelinpesa

Kronans Droghandel A.B.

Mannings Limited

Marupi-Merck Sharp & Dohme K.K.

Merck Sharp & Dohme of India Limited

Merck Sharp & Dohme (New Zealand) Limited

Merck Sharp & Dohme of Pakistan Limited

Merck Sharp & Dohme (Thailand) Ltd.

Nippon Merck-Banyu Co., Ltd.

Torii & Co., Ltd.

Torungavinnslan h.f. Iceland

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

No. 81-1273

CHARLES A. BOWSHER,
COMPTROLLER GENERAL OF THE UNITED STATES,
AND UNITED STATES OF AMERICA,
Petitioners,

v.

MERCK & CO., INC.

No. 81-1472

MERCK & CO., INC.,
Petitioner,

v.

CHARLES A. BOWSHER,
COMPTROLLER GENERAL OF THE UNITED STATES,
AND UNITED STATES OF AMERICA

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR MERCK & CO., INC.

Merck & Co., Inc. ("Merck") submits this brief as respondent in No. 81-1273 and petitioner in No. 81-1472.

STATEMENT

A. Introduction

This case involves the scope and purpose of the authority granted to the Comptroller General by Congress in 1951 to examine certain books and records of private companies that enter into government contracts. The relevant statutory provisions, 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c), require that negotiated government procurement contracts contain a clause granting the Comptroller General the right to examine those records of the contractor "that directly pertain to, and involve transactions relating to, the contract."[1]

Relying on the access-to-records clauses contained in four Merck contracts, the Comptroller General in 1974 issued a demand to Merck for access to virtually all of its cost records. (J.A. 17a-20a). Identical demands also were issued to five other pharmaceutical companies—Bristol Laboratories Division of Bristol-Myers Company, SmithKline Corporation, Eli Liliy & Co., Abbott Laboratories, and Hoffman-LaRoche, Inc. The record in this case underscores the extraordinary nature of these access-to-records demands. The government's statement omits any discussion of the unusual origin of the 1974 demands, the specific characteristics of the contracts involved, and the unprecedented nature and the virtually unlimited sweep of the Comptroller General's demands. (Gov. Br. 4-8). An understanding of these matters is important to a resolution of the questions presented.

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[1] The language quoted in text is from 10 U.S.C. § 2313(b). The parallel language of 41 U.S.C. § 254(c) is slightly different, but there is no substantive difference in the two statutes. *See* 102 Cong. Rec. 13952 (1956).

B. Origin Of The Comptroller General's Demand

The access-to-records demands served on Merck and several other drug manufacturers in August 1974 were the product of persistent efforts by two Senators and their staff aides to secure cost data on individual pharmaceutical products for public dissemination. (J.A. 142a-152a, 165a-173a). These efforts originated in January 1971 during hearings on competition in the drug industry. At the hearings, Senator Gaylord Nelson suggested that the Comptroller General invoke his access-to-records authority "to take a look" at the costs incurred by pharmaceutical companies. *Hearings on Competitive Problems in the Drug Industry Before the Subcommittee on Monopoly of the Senate Select Committee on Small Business,* 92d Cong., 1st Sess. 8020 (1971).

Following the January 1971 hearings, Senator Nelson and his staff repeatedly urged the General Accounting Office (GAO) to take action to secure drug company cost records in order to enable them to publicize by "product and firm" selected instances of allegedly "high profits." (J.A. 142a-148a). During hearings held in May 1972, Senator Nelson questioned Comptroller General Staats about the status of GAO's efforts to obtain cost data concerning individual drug products. *Hearings, supra,* 92d Cong., 2d Sess. 8573 (1972). The Comptroller General responded that an attempt to develop costs on an individual product basis would be "a waste of time." *Id.* at 8578. He explained that "it would be impossible to develop from [the manufacturer's] internal accounts what their costs are with respect to an individual drug." *Id.* at 8573. In addition, the Comptroller General stressed that commercial market forces protect the government's interest in obtaining a fair price when purchasing drugs:

> "You have to recognize that again, the Government here is a very small customer, a very small

> customer—in most cases, less than 3 percent, or certainly less than 5 percent. So the companies are concerned with the commercial market. This is not without some protection to the Government. If they have to meet their competition in the commercial market, which represents 95 percent of the business, and the Government gets a discount from any other published price, it is a little hard on the face of it to say that the Government is not getting good prices." *Id.* at 8580-81.[2]

Dissatisfied with these responses, Senator Nelson continued to press the Comptroller General to secure cost data from pharmaceutical manufacturers by invoking the access-to-records provisions. *Id.* at 8581-83.

GAO responded to this pressure in June 1973 by proposing a voluntary, two-phase study of the economics of the pharmaceutical industry. (J.A. 28a-32a, 130a-131a). Merck and five other manufacturers stepped forward and agreed to participate on a voluntary basis in the first phase of the GAO study. After these companies participated in the extensive "Phase I" background study, GAO in April 1974 issued a proposal for its "Phase II" study, stating that the objective of this study was "to gather and develop the data necessary to make" a "presentation concerning salient economic and operational aspects of the industry." (J.A. 130a-141a).

Merck and the other companies that participated in Phase I were willing to proceed with Phase II but expressed reservations about aspects of the proposed study

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[2] Thus, as the Comptroller General has candidly acknowledged, the government is "a very small customer," not "a major purchaser of pharmaceuticals." (Gov. Br. 4). Moreover, the overall expenditure figures cited by the government are of little relevance here because more than 80 percent of the government's spending on pharmaceuticals is to reimburse third parties and not in the form of direct government purchases. (Gov. Br. 4 n.2).

that would have required them to give GAO access to highly confidential cost data without adequate assurances of confidentiality. (J.A. 32a). GAO concluded that confidentiality was consistent with the type of industry economic study in which it was interested and informed Senators Nelson and Kennedy and their staff assistants that "the information obtained on a cooperative basis would in our opinion, far exceed that which we might obtain following . . . litigation." (J.A. 108a-109a, 150a-151a). The Senators, who had prompted GAO to undertake the proposed study, objected since they were "primarily interested in the cost data from individual companies." (J.A. 114a, 150a). *See SmithKline Corp. v. Staats*, 668 F.2d 201, 203 (3d Cir. 1981), *petition for cert. pending*, No. 81-2082 (filed May 10, 1982).

Bowing to the Senators' wishes, the Comptroller General on August 26, 1974, issued formal access-to-records demands to the six companies that had voluntarily come forward to participate in the Phase I study. (J.A. 78a, 173a).[3]

C. Non-Cost-Based Nature Of The Four Contracts Involved In This Case

The Comptroller General's August 1974 demand letter requested access to Merck's records based on the access-to-records clauses contained in four government contracts for prescription drugs. (J.A. 17a-20a). GAO selected these contracts solely because they were entered into by one of the companies that had voluntarily participated in its Phase I study and because, as negotiated contracts, they contained a standard form access-to-records clause. (J.A. 76a, 78a). GAO has acknowledged that it does not suspect any impropriety by Merck or the

[3] At no time did either House of Congress or any committee or subcommittee request that GAO seek access to cost records of Merck or any other pharmaceutical company. (J.A. 79a-80a).

contracting officers in connection with these contracts and has conceded that it does not question the reasonableness of the prices charged the government under these contracts. (J.A. 41a-44a, 76a). In addition, GAO admits that it did not issue the access-to-records demand to Merck in order to audit the contracts. (J.A. 45a). Instead, as GAO documents reveal, the access-to-records demands were made by GAO to obtain cost data on individual drug products to satisfy the demands of two powerful Senators and to gather data to pursue the broad-based economic study outlined in its April 1974 Phase II proposal. (J.A. 142a-152a, 154a-155a).

The pharmaceutical products supplied under each of these four Merck contracts were standard commercial items sold by Merck in substantial quantities in the public market. (J.A. 41a). The price proposed by Merck for each contract was not based on Merck's costs but rather was based on the catalog price at which Merck sold the item to the general public or was otherwise determined by adequate price competition. The catalog prices of Merck's pharmaceutical products are not cost-based but are established on the basis of market factors such as the price of competing products. (J.A. 25a-26a, 33a-34a, 66a-68a). Consistent with the views expressed by the Comptroller General in his 1972 testimony, *supra*, p. 3, it has long been Merck's view that there is no reliable way of determining the fully distributed costs of creating, developing, producing, and selling a particular drug product in order to make its price cost-based. (J.A. 34a, 66a).

The government procurement officers accepted the price proposed by Merck as the fixed price included in each of the four contracts, and the price paid by the government under the contracts was the lowest price at which Merck sold each of the products to anyone at the time the contracts were awarded. (J.A. 26a, 42a). There was no actual negotiation about price and no request that

Merck submit cost or pricing data in connection with any of the four contracts, because the contracting officer in each instance found competitive factors present that the federal procurement statutes and regulations recognize as assuring "the basic reasonableness of the price." (J.A. 25a, 41a-45a, 75a).

Although each of the four contracts technically was a "negotiated" contract rather than an "advertised" contract —because these contracts were not awarded on the basis of simultaneous sealed bids—the contracts differ in several critical respects from most negotiated government procurement contracts. First, unlike various forms of "cost-plus" contracts, the price charged to the government was fixed and did not vary with Merck's cost of performing the contract. Second, the fixed price paid by the government was not established on the basis of cost data or cost estimates provided to the government contracting officer. Instead, the four contracts were non-cost-based, fixed-price contracts of the type characterized by Comptroller General Staats as "negotiated competitive contracts." *Hearings on the Review of Defense Procurement Policies, Procedures and Practices Before the Subcommittee for Special Investigations of the House Armed Services Committee,* 90th Cong., 1st Sess. 19 (1967).

D. Unprecedented Nature And Sweep Of The Access-to-Records Demand In This Case

The record in this case establishes that GAO had never before attempted to use its 1951 access-to-records authority to collect data from contractors for an industry economic study (or, indeed, for any other purpose except individual contract audits). (J.A. 47a, 83a-104a). The unique nature of these access-to-records demands is underscored by the fact that in *every* instance in which the Comptroller General employed his access-to-records authority in fiscal years 1974 and 1975 (the only years for

which the government submitted information for the record), GAO was conducting individual audits of cost-based contracts in order to determine the accuracy of cost and pricing data supplied to government procurement officers during the negotiation of the contracts. (J.A. 21a-23a, 46a).

In addition to the unprecedented nature of the access demand at issue here, the Comptroller General in these pharmaceutical company cases has adopted a new theory of the scope of the records encompassed by the standard form access-to-records clause. According to the government, any unallocated costs that are defrayed by general corporate revenues which include the payment made by the government under the contract are deemed to be "directly pertinent to and involve transactions relating to" the contract. (Gov. Br. I, 10, 17, 39-40). Under this theory, however, "there are no excludable records." *Bristol Laboratories Division of Bristol-Myers Co. v. Staats*, 428 F. Supp. 1388, 1390 (S.D.N.Y. 1977), *aff'd*, 620 F.2d 17 (2d Cir. 1980), *aff'd by an equally divided court*, 451 U.S. 400 (1981). At no time during the lengthy history of this litigation has the government pointed to any evidence that this sweeping interpretation of the scope of the Comptroller General's authority has been employed previously in seeking access to contractors' records.

E. Proceedings Below

After notifying the Comptroller General that it considered his August 1974 access demand illegal, Merck commenced this action on October 2, 1974, in the United States District Court for the District of Columbia seeking a declaratory judgment that the Comptroller General's demand for access to Merck's records exceeded his statutory authority. (J.A. 1a, 6a-9a). The United States subsequently intervened as a defendant and counterclaimed for

an injunction to enforce the Comptroller General's demand. (J.A. 10a-16a). Similar cases involving the demands served on the other pharmaceutical companies were brought by the companies or by the government in the Second, Third, and Seventh Circuits.[4]

Following discovery, the parties filed cross-motions for summary judgment. Merck contended that the Comptroller General's access demand was unlawful (i) because it was issued for unauthorized purposes—to gather private company cost data for individual Congressmen and to conduct a general economic study of the drug industry—rather than to enable GAO to conduct audits of the particular contracts listed in the demand letter, and (ii) because, in any event, records of costs are not "directly pertinent" to the non-cost-based contracts that were the predicate of the GAO demand. (Pet. App. 36a).

Although the government conceded that the access demand was not part of a contract audit (J.A. 45a), the district court did not determine the actual purpose underlying the demand. Instead, the court simply concluded that it was "satisfied that the survey proposed by the Comptroller in this case . . . will facilitate supervision of the procurement process and is within his authority." (Pet. App. 38a).[5]

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[4] *See Bristol Laboratories Division of Bristol-Myers Co. v. Staats*, 428 F. Supp. 1388 (S.D.N.Y. 1977), *aff'd*, 620 F.2d 17 (2d Cir. 1980), *aff'd by an equally divided court*, 451 U.S. 400 (1981); *SmithKline Corp. v. Staats*, 483 F. Supp. 712 (E. D. Pa.), *cert. before judgment denied*, 449 U.S. 1038 (1980), *vacated and remanded*, 668 F.2d 201 (3d Cir. 1981), *petition for cert. pending*, No. 81-2082 (filed May 10, 1982); *Eli Lilly & Co. v. Staats*, 574 F.2d 904 (7th Cir.), *cert. denied*, 439 U.S. 959 (1978); *United States v. Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979).

[5] The government is incorrect in stating that the district court "rejected Merck's arguments that the Comptroller General's request was based on the assertedly improper purpose of 'conduct[ing] an economic survey of the pharmaceutical industry.' " (Gov. Br. 6). The district court acted on cross-motions for summary judgment, and thus did not resolve any factual issue concerning the actual purpose of the demand for access to Merck's records.

On the second issue, the nature of the documents that are properly subject to an access demand, the district court took an intermediate position. With respect to Merck's claim that no cost records are "directly pertinent" to the four contracts, the court concluded that the direct manufacturing and overhead costs incurred in producing the specific drug items purchased by the government are "directly pertinent" to the contracts. (Pet. App. 39a). However, the court also held—relying on the district court decision in *Bristol*—that the Comptroller General has no right under the access-to-records clause to examine Merck's records of indirect costs, such as its costs for "research and development, marketing and promotion, distribution, and administration" (Pet. App. 40a).

Both the government and Merck appealed. The court of appeals affirmed in a *per curiam* opinion joined by Judges Robb and Tamm, with Judge Mikva concurring in part and dissenting in part. (Pet. App. 1a-32a). Thus, three circuits—the Second, Third, and District of Columbia—have rejected the GAO's sweeping interpretation of the access-to-records provision, holding that the access-to-records demands issued to Merck and the other pharmaceutical companies exceeded its statutory authority.[6]

SUMMARY OF THE ARGUMENT

This case involves an unprecedented attempt by the General Accounting Office to transform carefully circumscribed authority granted to the Comptroller General by

[6] Each of these courts declined to follow the Seventh Circuit's earlier decision in the *Lilly* case sustaining the Comptroller General's position. The weight of the *Lilly* decision itself was subsequently eroded, even within the Seventh Circuit, by the reluctant concurrences of two members of the panel in *United States v. Abbott Laboratories, supra*, 597 F.2d at 674 (Pell, J. concurring), 675 (Wood, J., concurring), who expressed doubt that *Lilly* had been correctly decided.

Congress in 1951 into a virtually limitless right to demand access to confidential financial records of private companies that enter into procurement contracts with the government. The implications of the position advanced by the government are staggering: on the basis of a single contract involving a sale of as little as $2,500 worth of one pharmaceutical product, GAO asserts that it is entitled to examine records of hundreds of millions of dollars of expenditures for research and development, marketing and promotion, distribution, and administration made as part of a company's overall business operations. GAO claims a right to demand access to records dating back as much as 20 years, to a time before the drug product purchased by the government was even developed.

I

The court of appeals properly affirmed the judgment of the district court denying the Comptroller General's request for access to Merck's indirect costs. As the district court found, "'[i]t is inconceivable that . . . any contracting firm, could have understood this clause to authorize the sweeping power of inspection claimed by the GAO.'" Pet. App.39a, *quoting Bristol Laboratories Division of Bristol-Myers Co. v. Staats, supra,* 428 F. Supp. at 1391.

A. GAO's sweeping demand for access to Merck's records conflicts with the express limiting language employed by Congress in granting the Comptroller General the right to examine certain books and records of government contractors. The governing statutes, 10 U.S.C. §2313(b) and 41 U.S.C. § 254(c), contain two significant phrases of limitation. GAO may only demand access to records that (i) "directly pertain to" the contract and (ii) "involve transactions relating to the contract." The government's claim that GAO has the right to examine all

"costs defrayed from commingled general revenues that include the government's payments under the contract" (Gov. Br. 14) cannot be reconciled with the language of the access-to-records statutes. Because Merck's indirect costs played no role in the negotiation, pricing, or performance of the four non-cost-based, fixed-price contracts involved in this case, records of these general costs do not "directly pertain to, or involve transactions relating to the contracts" and thus fall outside the limited scope of GAO's access-to-records authority.

B. The legislative history of the access-to-records statute confirms the narrow reach of the Comptroller General's access authority. Both the origin of the statute in temporary, emergency Korean War legislation and the statements of purpose by its sponsor, Representative Hardy, demonstrate that the access authority was intended to enable GAO "to make effective audits" in order to deter "improprieties in the negotiation of Government contracts." 97 Cong. Rec. 12611, 13198 (1951). When, as in this case, no cost data are submitted during the negotiation process and when contract payments are fixed and thus do not depend on the contractor's cost of performance, the contractor's cost records are irrelevant to the GAO audit contemplated by Congress.

C. Even if consideration of GAO's administrative interpretation of the statute were appropriate, despite the plain thrust of the statutory language and legislative history, this inquiry would not assist the government. GAO's current interpretation of the access-to-records statutes conflicts with GAO's contemporaneous construction of the proposed statute presented to Congress during its consideration of the bill. The new, expansive theory asserted here also conflicts with GAO's repeated acknowledgments of the limits of its access authority.

D. Far from impeding GAO's ability to discharge its responsibilities, the denial of the Comptroller General's

unprecedented demand for Merck's records does not pose the slightest risk to GAO's continued use of the access-to-records statute to audit individual contracts in order to deter or detect abuses in the negotiation of government contracts.

II

A. The court of appeals erred in upholding the district court's judgment permitting GAO access to records of Merck's direct production costs. Application of the words of limitation contained in the statute demonstrates that no cost records are "directly pertinent" to the non-cost-based, fixed-price contracts involved in this case. Merck's production costs were irrelevant to the formation or pricing of these contracts, because the contracts were negotiated on the basis of the catalog price at which Merck sold standard commercial items to the public or on the basis of other evidence of adequate price competition, rather than on the basis of cost data or estimates submitted to the purchasing agency.

B. This conclusion coincides with the lines drawn by Congress in related procurement statutes. In several statutes, Congress has provided expressly that cost and pricing data need not be submitted to the government in connection with the negotiation or review of non-cost-based contracts for standard commercial items. This pattern of procurement legislation confirms that no cost records are "directly pertinent" to the contracts here.

III

A. The court of appeals also erred in permitting GAO access to any of Merck's records because the Comptroller General's demand for access to Merck's records

was not made for a congressionally authorized purpose. The record in this case establishes, as other courts have found, that the Comptroller General issued his August 1974 access-to-records demands to Merck and five other pharmaceutical manufacturers in order to placate the desire of two Senators and their staff aides to secure confidential drug company cost data and to gather data for an economic study of the pharmaceutical industry. Congress did not authorize the Comptroller General to demand access to records of private companies for either of these two purposes or for the pretextual purpose of "assessing the adequacy of procurement techniques."

ARGUMENT

I. THE COURT OF APPEALS CORRECTLY REJECTED GAO'S DEMAND FOR ACCESS TO RECORDS OF MERCK'S INDIRECT COSTS.

A. GAO's Sweeping Access-To-Records Demand Conflicts With The Language of the Statute.

As this Court repeatedly has stated, the "starting point in every case involving construction of a statute is the language itself." *Southeastern Community College v. Davis,* 442 U.S. 397, 405 (1979). "Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive." *Bread Political Action Committee v. FEC,* 455 U.S. ___, ___, 50 U.S.L.W. 4291, 4292 (No. 80-1481, decided March 8, 1982). Here, an examination of the statutory language demonstrates that the interpretation of the access-to-records clause advanced by the government is, as three circuits now have held, "untenable." *Bristol Laboratories Division of Bristol-Myers Co. v. Staats, supra,* 620 F.2d at 18.

The language employed by Congress in the statutes on which the Comptroller General's access-to-records demand is based—10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c)—differs markedly from language previously used to define the Comptroller General's right of access to records of government departments. The statute applicable to government departments grants the Comptroller General "access to and the right to examine *any* books, documents, papers, or records of *any* such departments or establishment." 31 U.S.C. § 54 (emphasis added). Congress, however, added two significant phrases of limitation in granting GAO access to the records of private companies. Those phrases restrict GAO to records that (i) "*directly pertain to*" *the contract* and (ii) "*involve transactions relating to the contract.*" *See Bristol Laboratories Division of Bristol-Myers Co. v. Staats, supra,* 428 F. Supp. at 1390 ("All of the underscored phrases are words of limitation.").

The government's sweeping interpretation of GAO's access-to-records authority completely ignores the express limiting language of the statute. According to the government, the Comptroller General has the right to examine all "costs defrayed from commingled general revenues that include the government's payments under the contract." (Gov. Br. 14). Since most manufacturers "commingle" revenues received from all sources and use their general revenues to pay for the full range of operating and capital expenses, the government's "commingling" theory bears no relationship to the language of the statute. A company's expenditure of revenue derived from a particular government contract may be completely unrelated to the product purchased by the government. For example, the general cash account to which a government payment is credited may be used to purchase raw materials for the manufacture of an entirely different product. Or revenues that include payments from a sale to the government may

become part of an investment in the stock of another corporation, or be used as part of a capital expenditure involving the construction of new buildings. In virtually all cases, the revenues earned on a particular government contract will be received long after performance and, therefore, will not be used to pay the costs incurred in performing that contract. The government's theory thus conflicts with the statutory language by permitting examination of cost records that are completely unrelated to the contract on which the access demand is premised and that have nothing to do with the product that was procured through the contract.

As the district court noted in *Bristol,* the common business practice of including payments under government contracts as part of general corporate revenues means that "there are no excludable records under the Government's theory" and the contractor "will be required to make available virtually all of its books and records, because although it is impossible to trace the use of government dollars, those dollars contribute to the fund from which all of the company's expenses are paid." 428 F. Supp. at 1390. Translated into practical terms, the government's argument would mean that, based on a single negotiated procurement contract involving a mere $2,500 purchase,[7] GAO would be entitled to access to all of the records of Merck's research and development expenditures, which exceeded $100,000,000 in 1974 (J.A.35a), and now exceed $300,000,000 annually.[8] Moreover, the government's

[7] At the time the four Merck contracts involved in this case were entered into, the standard form access-to-records clause was required by regulation to be incorporated in all contracts exceeding $2,500. The minimum dollar amount in effect at the present time is $10,000. *See* 41 C.F.R. § 1-16.901-32 (1981).

[8] *See* Merck & Co., Inc.'s Form 10-K for the Fiscal Year Ended December 31, 1981, Securities and Exchange Commission File No. 1-3305, at 4 (filed on March 19, 1982).

theory places no limit on the number of years for which cost records could be demanded. Indeed, GAO has taken the position in this case that an access-to-records demand involving a single contract may encompass records dating back as far as 20 years. (J.A. 50a-51a, 124a).

The district court in this case recognized that the government's theory departs from any reasonable construction of the language of the access-to-records clause. It found that it is " 'inconceivable that . . . any contracting firm, could have understood this clause to authorize the sweeping power of inspection claimed by the GAO.' " Pet. App. 39a, *quoting Bristol Laboratories Division of Bristol-Myers Co. v. Staats, supra,* 428 F. Supp. at 1391. As the Third Circuit recently concluded, "the Government's interpretation of 'directly pertinent' admits of no doctrinal limitation on its access powers" and "its argument gives the phrase no effect." *SmithKline Corp. v. Staats, supra,* 668 F.2d at 211. The government's theory, therefore, should be rejected as inconsistent with the language of the access-to-records statute.[9]

In interpreting legislative enactments, it has long been recognized that a court's "duty [is] 'to give effect, if possible, to every clause and word of a statute.' " *United States v. Menasche,* 348 U.S. 528, 538-39 (1955), *quoting Montclair v. Ramsdell,* 107 U.S. 147, 152 (1883); *see Fidelity Federal Savings and Loan Ass'n v. De La Cuesta,*

[9] The government asserts that the virtually unlimited right of access claimed under its theory is "neither unique nor unreasonable" when compared with discovery in civil litigation, grand jury subpoenas, IRS summonses, and civil investigative demands. (Gov. Br. 41-42). This "argument" ignores the limiting language employed by Congress in defining the scope of GAO's access authority and thus is completely irrelevant. Moreover, this strained comparison underscores the breathtaking sweep of GAO's access demand since it is extremely unlikely that a demand to review all of Merck's indirect cost records dating back over a 20-year period could be sustained under any of the "grab bag" of devices listed by the government.

___ U.S. ___, ___, 50 U.S.L.W. 4916, 4922 (No. 81-750, decided June 28, 1982). The district court and the court of appeals properly discharged this duty in holding that GAO's right of access under non-cost-based contracts does not extend to records of Merck's indirect costs, because these costs simply do not "directly pertain to, or involve transactions relating to" the four Merck contracts involved in this case.

Merck's indirect costs do not "directly pertain to" these contracts because they played no role in the negotiation, pricing, or performance of the contracts. *See* pp. 6-7, *supra*. Similarly, records of Merck's indirect costs do not "involve transactions relating to the contract." Merck's expenses for research and development, marketing and promotion, distribution, and administration were generated as part of its overall costs of doing business. They were not incurred as a result of the four government contracts involved in this case. For example, Merck's extensive expenditures for research and development do not depend on or vary with Merck's individual sales contracts. Because of the long lead time required before a new drug can be marketed, all of the research and development expenses related to the creation of the particular drug products purchased by the government through the four Merck contracts were incurred many years before the contracts were negotiated.[10] These indirect costs thus fall outside the definition of the access-to-records authority set forth in the language of the statute.

The government does not attempt to square its sweeping demand for access to Merck's records with the statutory language. Instead, the government asserts that

[10] It now takes, on average, seven to ten years just to complete the elaborate testing process required by the FDA before a new drug, once developed, can be marketed. 127 Cong. Rec. S 674 (daily ed.; Jan. 27, 1981) (remarks of Sen. Mathias).

the decision below conflicts with the statutory language because that "language contains no exclusion of records relating to costs that a contractor chooses not to allocate." (Gov. Br. 17). This argument mischaracterizes the position taken by the courts below. Merck's indirect costs were held to be beyond the scope of the Comptroller General's authority because they do not "directly pertain to or involve transactions relating to the contract," not because they are "unallocated." (Pet. App. 37a-39a). The district court's opinion, which was affirmed by the court of appeals, makes no reference to "allocated" and "unallocated" costs. (Pet. App. 35a-40a). Instead, the court distinguished between the direct costs of producing the products purchased under the contracts and the host of general, indirect costs which the Comptroller General claims the right to examine. (Pet. App. 37a-39a).

The government attempts to pull its argument up by its own bootstraps, asserting that the records of indirect costs sought by the Comptroller General would certainly be covered by the access authority if Merck had attempted to allocate its indirect costs to specific contracts. (Gov. Br. 39). Such an internal allocation, which of necessity would reflect some arbitrary ratio or formula, would not make the various categories of indirect costs "directly pertinent" to the non-cost-based contracts involved in this case. However, it is significant that Merck does not normally make such artificial allocations,[11] because it confirms that

[11] Merck does not believe that such allocations are meaningful. The government concedes that "there is no generally accepted accounting principle governing allocation of costs." (Gov. Br. 34). It is not possible to review Merck's records and isolate, for example, the total research and development costs expended in developing a single drug product. In addition, only an arbitrary formula could be employed to assign a portion of prior unsuccessful research to products that are actually marketed. The regulations cited by the government (Gov. Br. 38 n.21) do not provide a means of making these allocations.

Merck did not take indirect costs into account in establishing its catalog prices.

The government also argues that all of Merck's indirect costs must be treated as directly pertinent to each individual procurement contract because indirect costs constitute a large proportion of total costs in the pharmaceutical industry. (Gov. Br. 33-36). This is a strange argument, however, for the relative size of a contractor's direct and indirect costs cannot alter the statutory standard or its application.[12] The fact that general research, for example, may total fifty percent rather than five percent of the contractor's overall costs does not affect the statutory standards for demanding access to confidential cost records.[13]

(footnote continued)

Moreover, if the government wants to apply some mechanical formula to "allocate" research and development costs to particular products or contracts, it would not need access to records of each individual cost incurred by Merck. All that would be needed would be yearly research and development totals and yearly sales totals, both of which are publicly available in Merck's financial statements.

[12] The government relies on the Seventh Circuit's conclusion in the *Lilly* case that all indirect costs that constitute more than a "minimal" portion of the contractor's total costs are directly pertinent to each individual government contract. (Gov. Br. 33-34); *see Eli Lilly & Co. v. Staats, supra*, 574 F.2d at 914. That decision, which pushes the statutory language far beyond the breaking point, has been undermined by a later Seventh Circuit decision and rejected by all three courts of appeals that subsequently addressed this issue. *See* p. 10 and n. 6, *supra*.

Moreover, the approach advocated by the government would be unmanageable. It would make GAO's right of access turn on the ratio of the contractor's direct and indirect costs. There is no indication that Congress intended such an *ad hoc* application of the uniform access-to-records clause it directed be placed in all negotiated contracts. *See SmithKline Corp. v. Staats, supra*, 668 F.2d at 212.

[13] The implication of the government's argument is that the GAO is to use its access authority to determine whether, for example, a manufacturer spends "too much" on research. There is not a shred of support for this assumption in the text of the access statute or in its history. Judgments of this sort are the province of management and are tested in the competitive marketplace.

B. The Legislative History Of The Access-to-Records Statute Underscores The Limited Authority Granted The Comptroller General.

An examination of the legislative history confirms what the language clearly indicates: rather than conferring "a broad right of access in order to determine the reasonableness of the contract price" (Gov. Br. 17-18), Congress intended to limit GAO to those records of private companies that are necessary to conduct individual contract audits in order to deter and detect improprieties in the negotiation of procurement contracts.

1. The Limited Purpose and Scope of the Access-to-Records Statute is Evident from Its Origin in Emergency Legislation.

The access-to-records clauses involved in this case were required by an October 1951 statute. Act of October 31, 1951, Pub. L. 82-245, 65 Stat. 700. That statute was modeled on, and as originally proposed was identical to, a January 1951 amendment to the First War Powers Act. *See* Act of January 12, 1951, 64 Stat. 1257. The legislative history of that predecessor statute, which the government studiously ignores, is critical to a proper understanding of the Comptroller General's access-to-records authority. *See, e.g., Oscar Mayer & Co. v. Evans,* 441 U.S. 750, 755-56, 758 (1979); *Cannon v. University of Chicago,* 441 U.S. 677, 694-98 (1979).

The January 1951 amendment to the First War Powers Act was adopted in response to crisis conditions. As a result of rampant inflation caused by the Korean War, many defense contractors committed to supplying the government under fixed-price contracts were unable to meet their obligations because their contract prices were "completely out of line with rising costs." H.R. Rep. No. 3227, 81st Cong., 2d Sess. 3-4 (1950); *see* S. Rep. No.

2686, 81st Cong., 2d Sess. 2 (1950). To deal with this situation, President Truman asked Congress to give him the same emergency authority to modify contracts that had been granted the President during World War II by the First War Powers Act of 1941. Congress reinstated the President's emergency contracting powers, but only for a period of 18 months. *See* S. Rep. No. 2686, *supra,* at 3; Act of January 12, 1951, § 2, 64 Stat. 1258.

The access-to-records provision in the January 1951 statute was added on the House floor. During the House debates, some Representatives expressed concern that the emergency authority to modify contract prices might be abused. Representative Marcantonio, for example, objected to the bill because "[t]here is not a single word which safeguards the Government against being subjected to the worst kind of war profiteering. The discretion here is absolute. The sky is the limit." 96 Cong. Rec. 17045 (1951). In order to deter fraud and profiteering in the process of modifying contracts, Representative Hardy introduced an amendment providing the Comptroller General with the authority to examine "pertinent" records relating to contracts modified pursuant to the statute. *Id.*

The following colloquy between Representative Celler and Representative Fulton underscores the limited deterrent purpose of the access-to-records provision:

> "Mr. FULTON. First in reference to the Hardy amendment, will the gentleman explain in more detail the powers of the GAO under this legislation?
>
> "Mr. CELLER. As I understand the Hardy amendment, the powers given are like a Damoclean sword that will hang over the heads of the contractors whose contracts are changed. *The amendment will give power to the General Accounting Office to go into the books and delve into the records of these con-*

> *tractors who have been relieved to determine whether or not there is fraud or overreaching or whether they have done anything untoward,* in which event reports will be made and suitable action may be taken. The power of investigation and inquiry of the General Accounting Office should be an excellent deterrent. Those reports also would be of great help subsequently on the question of renegotiation." 96 Cong. Rec. 17123 (1951) (emphasis added).[14]

This colloquy reflects GAO's own contemporaneous interpretation of its authority under the statute. In similar letters to the House and Senate committee chairmen, GAO stated that the "purpose and intended effect of such legislation is clearly explained" in the Fulton-Celler exchange. *See* H.R. Rep. No. 791, 82d Cong., 1st Sess. 4 (1951); S. Rep. No. 603, 82d Cong., 1st Sess. 4 (1951).

The legislative history of the First War Powers Act amendments thus establishes that the access-to-records provision was intended as a deterrent to abuse of emergency authority to relieve contractors of the burden posed by unexpected wartime inflation. The provision was to permit GAO to verify that companies that sought to have their contract prices adjusted upward actually had sustained the cost increases for which they sought additional payments.

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[14] As Representative Celler's remarks indicated, the Comptroller General's audit also was intended to assist the government in exercising its rights under the Renegotiation Act to recoup payments made to contractors resulting in unreasonable or extraordinary profits. The government has acknowledged, however, that the Renegotiation Act did not apply to the four Merck contracts involved in this case because Congress has exempted from renegotiation all contracts for standard commercial items whose prices are set in the competitive market place. 50 U.S.C. App. §§ 1216(e)(1)(A) & (4)(B). (J.A. 42a-43a); *see* p. 43, *infra*.

2. The Permanent Access-to-Records Statute was Enacted for the Same Limited Purpose.

Shortly after the adoption of the First War Powers Act amendments, Representative Hardy learned that government procurement officers were negotiating contract modifications under two permanent procurement statutes —the Armed Services Procurement Act of 1947 and the Federal Property and Administrative Services Act of 1949. *See* 97 Cong. Rec. 13198 (1951). Those statutes lacked any access-to-records provisions. *Id.* " In order to plug this loophole," Representative Hardy introduced a bill to require the inclusion of access-to-records clauses in contracts negotiated under these statutes. *Id.* Both the House and Senate reports and Representative Hardy's floor statements underscore that the bill was intended "merely" to "carr[y] into our general procurement statutes the same principle" embodied in the First War Powers Act amendments. *Id.* (remarks of Rep. Hardy); *see id.* at 13199, 13200; H.R. Rep. No. 791, *supra,* at 2; S. Rep. No. 603, *supra,* at 2.

Echoing Representative Celler's explanation of the purpose of the access-to-records provision in the January 1951 legislation, Representative Hardy stated that this related bill was intended "to place on the statute books a law which will act as a deterrent to improprieties in the negotiation of Government contracts." 97 Cong. Rec. 13198 (1951). The access-to-records provision sought to provide such a deterrent by empowering "the Comptroller General to make effective audits" of the accounts of government contracting officers. *Id.* at 12611 (remarks of Rep. Hardy). The legislation would increase the effectiveness of the GAO audit by permitting GAO "to check the transaction, both from the Government records

and the contractors' books." *Id.* at 13198 (remarks of Rep. Hardy). As Representative Hardy explained:

> "[T]he audit which GAO performs is directed primarily to the accounts of the accountable officers of the Government, and not to the contractors themselves. The GAO is required by law to take exceptions against accountable officers for *erroneous or illegal payments.*" *Id.* at 13197 (emphasis added).[15]

The sponsor's statements emphasizing the statute's limited audit purpose are reinforced by two important floor amendments circumscribing the Comptroller General's access-to-records authority. As originally introduced,

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[15] At the time the statute was adopted, GAO's primary function, as the office's name implies, was the examination and settlement of the accounts of government disbursing officers:

> "The central and best known of the GAO's responsibilities was the *audit of expenditure vouchers* (mostly after they had been paid) and the *settlement of accounts*—primarily those of the various disbursing officers scattered around the government—which were required to be submitted periodically along with all their supporting documents. The GAO's checking of individual vouchers was intended to assure that the money was authorized and available, the payment was lawful in every respect, the proper procedures had been followed, *and no fraud or other irregularity* was involved. If any objections were raised, notices of exception were issued to the responsible officers, and unless satisfactory explanation could be made the payments were disallowed." F. Mosher, *The GAO: The Quest for Accountability in American Government* 72-73 (1979) (footnote omitted; first emphasis in the original; second emphasis added).

Commentators writing in the early 1950's, shortly after the access-to-records statute was adopted, noted that the access authority was intended to enable GAO to discharge these audit and settlement responsibilities. *See, e.g.*, Cable, *The General Accounting Office and Finality of Decisions of Government Contracting Officers*, 27 N.Y.U.L. Rev. 780, 782 (1952); Welch, *The General Accounting Office in Government Procurement*, 14 Fed. B.J. 321, 326 (1954).

the Hardy bill employed the language of the First War Powers Act provision which limited the Comptroller General to "pertinent" records of a contractor "involving transactions related to" the specific procurement contract. During the debates in the House, a number of Congressmen voiced concerns about possible abuse of the access authority by GAO personnel. In order to allay these concerns, the House narrowed the scope of the Comptroller General's access authority to those records that are "directly" pertinent to the contract. Representative Hoffman, who sponsored this amendment, stated that it was intended "to limit the 'snooping' that may be carried on under this bill." 97 Cong. Rec. 13377 (1951). As the Third Circuit recently concluded, this legislative history "manifests a strong congressional intent to prevent unlimited 'snooping.'" *SmithKline Corp. v. Staats, supra,* 668 F.2d at 210.

Another amendment to the original Hardy bill limited the period during which the Comptroller General may demand access to a contractor's records to three years from the date of final payment under the contract. This amendment underscores the fact that Congress viewed the access-to-records authority as a limited adjunct to GAO's power to audit the accounts of government disbursing officers in order to disallow erroneous payments, a power also restricted by statute to a three-year period. *See* 31 U.S.C. § 82i. As Representative Hardy explained:

> "the General Accounting Office is primarily concerned with settling the accounts of the accountable officers of the Government, and it is restricted by law to a 3-year period with respect to disallowing any erroneous payments on the part of accountable officers. For that reason, I scarcely think that the General Accounting Office would come in, and want to examine the books

> of a contractor after a period in excess of 3 years." 97 Cong. Rec. 13199 (1951).[16]

These amendments confirm that the purpose of the access right is limited to auditing the conduct of contract negotiations and to reviewing records of contractors supporting their claims for payment.

In accord with that purpose, when cost and pricing records are submitted as part of the negotiation process or in connection with a claim for payment under a cost-reimbursement contract, those records are "directly pertinent" to the contract. By contrast, when no cost data or representations about costs are submitted to support the proposed contract price, and when contract payments do not depend on the contractor's cost of performance, the contractor's cost and pricing records are irrelevant to the type of GAO audit contemplated by Congress.

The only records that are pertinent to an audit of the non-cost-based, fixed-price contracts involved in this case are those required to verify (i) that the contractor actually had an established catalog price for the item procured, (ii) that the item was sold in substantial quantities to the general public at the catalog price, (iii) that the contractor delivered the product specified, and (iv) that the sum received in payment from the government was the correct amount due under the contract. From the outset of this litigation, Merck has offered to make such records available to the GAO. (J.A. 33a).

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[16] The relationship between the three-year time limit and the bill's purpose to facilitate audits of the accounts of government contracting officers is reenforced by Representative Hardy's refusal to agree to any limitation period other than the three-year period applicable to GAO's authority over the settlement of accounts. *See* 97 Cong. Rec. 13199 (1951) (colloquy involving Representatives Hardy, Burton, and Gross).

3. The Government's Interpretation of the Access-to-Records Statute Conflicts with the Legislative History.

The government attempts to overcome the limiting language of the statute by resorting to its own view of the legislative history. The fundamental failing of the government's argument, however, is the absence of any affirmative support for the government's repeated refrain that the access-to-records authority was designed to enable GAO to evaluate the abstract "reasonableness" of the contract price and, through that process, to assess the adequacy of government procurement procedures. (Gov. Br. 17-18). The absence of any reference to such an "assessment function"—despite a fairly extensive discussion of the legislation during the congressional debates—strongly suggests that Congress' "purpose was solely to provide a method to discover fraudulent activities and not a means by which government agencies can improve their procurement techniques for use in future contracts." Note, *Government Contracts: Contractor's Obligation to Allow Examination of Records Under 10 U.S.C. 2313(b)*, 72 Dick. L. Rev. 687, 691 (1968).

The government's brief is seriously misleading in its attempt to create the appearance that there is legislative history supporting its interpretation of the statute. The dubious technique employed is the repeated use of a few carefully edited phrases from the House debates. (Gov. Br. 11-12, 18-19). Although there is no statement in the legislative history linking the access-to-records authority to an examination of the contract *price*, the government's brief creates that impression by simply inserting the bracketed word "price" where it does not appear in quotations from the legislative history (Gov. Br. 11, 18, 19), or by characterizing the passages as manifesting a concern about the reasonableness of the *price* of all negotiated contracts (Gov. Br. 23, 33, 41 n.23). As they

appear in the Congressional Record, however, the passages excerpted by the government deal only with misrepresentations of *costs* by the contractor during the negotiation process. *See* 97 Cong. Rec. 13198 (1951).[17]

The government also falls back on statements of concern made by opponents of the bill (Gov. Br. 20-21). As this Court repeatedly has cautioned, however, statements by opponents "have scant probative value" because in "their zeal to defeat a bill, they understandably tend to overstate its reach." *National Woodwork Manufacturers Association v. NLRB*, 386 U.S. 612, 639-40 (1967). "The fears and doubts of the opposition are no authoritative guide to the construction of legislation." *Schwegmann Brothers v. Calvert Distillers Corp.*, 341 U.S. 384, 394 (1951). These principles apply with particular force here because the bill's sponsor, Representative Hardy, responded to the opponents' statements by carefully explaining that the access-to-records provision would not afford GAO broad visitorial powers but would be limited to those situations in which GAO had "reason to suspect fraud or bad faith or illegality." 97 Cong. Rec. 13377 (1951). Not content with such words of reassurance, one of the opponents, Representative Hoffman, then successfully

[17] The passages cited by the government are taken from Representative Hardy's floor statement in which he explained that his "main purpose in offering this bill was to place on the statute books a law which will act as a deterrent to improprieties in the negotiation of Government contracts." 97 Cong. Rec. 13198 (1951).

To illustrate his concern, Representative Hardy used examples involving improper inflation by the contractor of the "overhead rate" quoted to the government procurement officer during the negotiation process. *Id.* He stated that the audit conducted by GAO using the access-to-records authority could deter and detect such misstatements of costs during contract negotiations by enabling "the General Accounting Office to look behind the *rate* which had been established" for overhead in the contract. *Id.* (emphasis added). The government unjustifiably substitutes "price" for "rate" and thus alters the meaning of the explanation.

sponsored the amendment to restrict GAO's right of access to "directly" pertinent books and records, thus further tightening the limitations placed on the access power. *Id.* [18]

Finally, the government argues for an expansive reading of the access-to-records provision by repeatedly referring to the Comptroller General's broad statutory powers under 31 U.S.C. §§ 53(a), 60, 65(a), to investigate and make reports concerning the expenditures of the executive branch. (Gov. Br. 10, 11, 14-15, 17, 19). The fact that GAO may be empowered by other statutes to conduct broad studies of governmental expenditures, however, does not mean that Congress intended to require private contractors to make their confidential data available for use in those studies. One would have expected at least one Congressman to have referred to those other functions in addition to the GAO's audit responsibility if Congress viewed the access right as extending to those functions. Significantly, none of the other statutes relied upon in the government's brief was even mentioned in the legislative history of the access-to-records statute.[19]

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[18] The government seeks to dismiss this important amendment and the statement of purpose made by its sponsor, Representative Hoffman, because he remained opposed to the legislation even with his limiting amendment. (Gov. Br. 21). Here, too, the government ignores controlling principles of statutory interpretation which require that the statement of the amendment's sponsor regarding its purpose be accorded "substantial weight." *FEA v. Algonquin SNG, Inc.*, 426 U.S. 548, 564 (1976); *see North Haven Board of Education v. Bell*, ___ U.S. ___, ___, 50 U.S.L.W. 4501, 4504 (No. 80-986, decided May 17, 1982) (remarks of "the sponsor of the language ultimately enacted, are an authoritative guide to the statute's construction").

[19] The government attempts to link these other provisions to the 1951 access-to-records statute by seizing upon Representative Hardy's statement that one of the major purposes of the bill was to give the Comptroller General "the proper tools to do the job the Congress has

(footnote continues)

In sum, the government's sweeping interpretation of the access-to-records statute is incompatible with (i) its origin in temporary emergency legislation that created a risk of fraud and overreaching, (ii) the deliberate addition of language that narrowed the scope of access, (iii) the limitation of the access right to the period during which GAO may audit accounts of government contracting officers to detect illegal or erroneous payments, and (iv) the limitation of the authority to negotiated contracts. These legislative choices would make no sense if Congress had intended to authorize GAO to use the access right for broad-gauged assessments of the reasonableness of the contract price in order to refine techniques for future government procurement efforts. Instead, each of these factors serves to confirm the statement of the statute's sponsor that the legislation was intended to promote effective contract audits in order to deter "improprieties in the negotiation of Government contracts." 97 Cong. Rec. 13198 (1951). As the Third Circuit concluded in the *SmithKline* case, "GAO's broad interpretation of the provisions is inconsistent with the congressional intent." 668 F.2d at 212.

C. GAO's Current Interpretation Of The Access-To-Records Provision Is Not Entitled To Judicial Deference.

The government places substantial reliance on what it asserts is GAO's "consistent and longstanding construction" of the access-to-records statute. (Gov. Br. 25-32). Even if the sweeping interpretation urged here by the government were a consistent and longstanding agency

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(footnote continued)

instructed him to do." 97 Cong. Rec. 13198 (1951); *see* Gov. Br. 11. Read in context, it is clear that Representative Hardy was discussing the GAO's principal function: auditing the accounts of government contracting officers in order to disallow erroneous or illegal payments. *See* 97 Cong. Rec. 13197-98, 13199 (1951) (remarks of Rep. Hardy).

position, it should not be accepted by this Court because it conflicts with "the clear meaning of a statute, as revealed by its language, purpose and history." *Southeastern Community College v. Davis, supra,* 442 U.S. at 411.[20] In any event, the Court should "accord no special weight" to GAO's current interpretation, because it is at odds with GAO's contemporaneous construction of the statute and with its repeated acknowledgments of the limits of its access authority. *See United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 858-59 n.25 (1975).

1. GAO's Current Interpretation Conflicts with Its Contemporaneous Construction of the Access-to-Records Statute.

As this Court has explained, an administrative construction of a statute "'carries most weight'" when adopted in connection with Congress' consideration of the legislation and when "'directly made known . . . to Congress in committee hearings.'" *SEC v. Sloan,* 436 U.S. 103, 120 (1978), *quoting Zuber v. Allen,* 396 U.S. 168, 192 (1969). Here the Acting Comptroller General formally presented GAO's contemporaneous interpretation emphasizing the limited purpose and scope of the access-to-records statute when the relevant congressional committees were considering the bill. *See* H.R. Rep. No. 791, *supra,* at 4-5; S. Rep. No. 603, *supra,* at 3-4.

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[20] Moreover, this is not a case in which Congress has granted an agency the power to issue regulations in order "to define a statutory term or prescribe a method of executing a statutory provision." *Rowan Cos. v. United States,* 452 U.S. 247, 253 (1981); *see General Electric Co. v. Gilbert,* 429 U.S. 125, 141-42 (1976). Here, Congress simply required that a standard clause be placed in negotiated government procurement contracts. It did not empower GAO to issue regulations and, in fact, no interpretive regulations or guidelines have ever been issued by GAO.

Indeed, since it is clear from the legislative history that Congress fashioned the language of the statute to limit GAO's access to the records of private companies (*see* pp. 25-27, *supra*), the agency's sweeping assertions of authority should be scrutinized closely.

GAO's official explanation of the Hardy bill expressed its view that the access-to-records provision was intended solely as a deterrent to abuses in the negotiation and modification of government contracts. In letters sent to the House and Senate committee chairmen, GAO stated that the "purpose and intended effect of such legislation is clearly explained" in the colloquy between Representatives Celler and Fulton quoted at pp. 22-23, *supra*. The GAO letters concluded:

> "It is apparent that the proposed legislation herein considered likewise *is intended as a deterrent to those persons who otherwise might abuse the authority* to negotiate certain contracts without advertising." H.R. Rep. No. 791, *supra*, at 4; S. Rep. No. 603, *supra*, at 4. (Emphasis added.)

The Comptroller General's contemporaneous understanding of the access-to-records statute is also set forth in his 1951 annual report to Congress. That report states that the access-to-records provision of the First War Powers Act amendments was intended "to strengthen General Accounting Office auditing" as a deterrent "in preventing fraud in Government contracts"; it characterizes the October 1951 access-to-records statute as extending "this same requirement" to contracts negotiated under the permanent procurement statutes. *Annual Report of the Comptroller General of the United States for the Fiscal Year Ended June 30, 1951*, at 67 (1951).

2. GAO's Current Interpretation Departs from Its Prior Use and Explanation of Its Access-to-Records Authority.

Not only does GAO's contemporaneous construction of the statute conflict with its position here, but other intervening GAO actions and statements reflect a more limited view of its access-to-records authority.

GAO historically has viewed its access-to-records authority as intended to facilitate audits of cost information supplied by contractors during the negotiation process. Thus, for example, the Comptroller General's 1955 annual report to Congress contains the following explanation of GAO's use of the access-to-records statute:

> "The examination of contract activities is concerned primarily with the operation and administration of those types of negotiated contracts under which the Government has a financial interest in the costs of performance. They usually are cost-reimbursement-type contracts and the various forms of price redetermination or incentive contracts under which the ultimate price is materially affected by costs of performance." *Annual Report of the Comptroller General of the United States for the Fiscal Year Ending June 30, 1955*, at 22 (1955).

The record in this case provides further evidence of GAO's focus on audits of cost-based contracts. In 1974 and 1975, GAO used its access-to-records authority to examine contracts and subcontracts totaling $814,900,000. (J.A. 22a-23a). In every instance, GAO employed its access authority to conduct audits of *cost-based* contracts in order to determine the accuracy of cost and pricing data supplied to government procurement officers during the negotiation process. (J.A. 46a).

Moreover, GAO has acknowledged the limited scope of its access-to-records authority on numerous occasions following the hearings relied upon by the government.[21]

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[21] The government relies upon statements made by GAO personnel during various committee hearings in 1963 and 1965. (Gov. Br. 26-30). Those statements, which are hardly contemporaneous assessments of the 1951 access-to-records statute, were made during the course of a dispute with another contractor over the scope of GAO's

(footnote continues)

In a determination of particular relevance to this case, the Acting Comptroller General ruled in 1967 that GAO has no right to examine records relating to a contractor's commercial business, even when review of such records would be necessary to determine whether a catalog-priced item was actually sold in substantial quantities to the general public, as the contractor had represented. GAO Memorandum B-162009-O.M. (J.A. 162a-163a). This limitation, which has been repeated in other opinions (J.A. 164a-165a), bars a far less intrusive inquiry into the contractor's commercial business than the broad-based demand for records of all Merck's indirect costs at issue in this case.

GAO also emphasized the limited scope of its access-to-records authority in the late 1960s and early 1970s when it sought expanded authority from Congress in order to perform "should cost" reviews of government contractors. GAO internal memoranda reveal that in 1970 GAO believed that it needed additional authorization from Congress in order to examine a variety of records, including those involving a contractor's "indirect costs"—the very type of records at issue in this case. *See* GAO Memorandum B-159896(.07) (J.A. 160a-161a). GAO also provided Congress with a memorandum emphasizing the limited nature of its access-to-records authority, including the uncertainty as to whether its access authority extended beyond direct production costs. *See* 115 Cong. Rec. 25800-01 (1969) (reprinting the GAO memorandum).

(footnote continued)

access right. Such self-serving statements are a particularly tenuous basis for interpreting the intended reach of GAO's authority. Furthermore, those statements merely reflect GAO's claim that it is empowered to use its access-to-records authority to examine the reasonableness of the contract price. *See* Gov. Br. 27-30. They do not support the sweeping theory advanced here to justify the demand for access to records of all of Merck's indirect costs.

Finally, none of the various GAO statements cited by the government addresses GAO's access to indirect costs in connection with non-cost-based, fixed-priced contracts of the type involved in this case. Because this litigation marks the first occasion in which GAO has articulated its current theory, there is, of course, no basis for according deference to this litigation-oriented interpretation.

3. Subsequent Congressional Actions Reveal a Continuing Intention to Circumscribe GAO's Access Authority.

The government asserts that Congress has approved GAO's interpretation of the access-to-records statute by its silence. (Gov. Br. 32). This Court, by contrast, repeatedly has warned that "legislative silence is a poor beacon to follow in discerning the proper statutory route." *Zuber v. Allen, supra,* 396 U.S. at 185; *see, e.g., Girouard v. United States,* 328 U.S. 61, 69 (1946). Moreover, the prerequisite to any such argument—a consistent, long-standing administrative construction that has been repeatedly presented to Congress and carefully considered by it—is plainly absent. *See SEC v. Sloan, supra,* 436 U.S. at 121 ("We are extremely hesitant to presume general congressional awareness of the Commission's construction based only upon a few isolated statements in the thousands of pages of legislative documents.").

Actions taken by Congress since the access-to-records statute was passed in 1951 belie GAO's claim that Congress has passively acquiesced in an assertion of sweeping authority. On only one occasion has Congress deliberately granted GAO the kind of broad-ranging authority it has attempted to assert here. As part of the Military Appropriations Act of 1970, Congress authorized GAO to demand access to contractors' records as part of a study of defense industry profits. *See* Pub. L. 91-121, § 408, 83 Stat. 204. Significantly, this authority was conferred only for one

year and was carefully limited to "only a single study." 115 Cong. Rec. 25793 (1969) (remarks of Senator Proxmire); *id.* at 25795 (remarks of Senator Ribicoff). In 1973, and again in 1975, Congress considered GAO-drafted proposals that would have authorized GAO to demand broad access to contractors' records in order to conduct profit studies of major government contractors. Congress declined to grant the authority. *See* S.2049 and S.3014 (introduced in the 93d Congress) and S.2268 (introduced in the 94th Congress). Since Congress withheld this power when GAO expressly sought it with respect to large contractors, it cannot be assumed that even broader power regarding all contractors already had been implicitly inserted in the 1951 legislation as a result of congressional silence.

D. Rejection Of GAO's Sweeping Interpretation Of The Access-To-Records Statute Will Not Impede Its Ability To Discharge Its Responsibilities.

The government asserts that the decision below should be reversed because it "impermissibly restrains GAO's ability to carry out its statutory mandate." (Gov. Br. 35). This appeal to the Court to disregard the language and legislative history of the statute should be rejected. *See TVA v. Hill,* 437 U.S. 153, 194 (1978) ("the wisdom or unwisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting a statute"). Moreover, the appeal rings hollow in this case.

For 30 years, GAO has been content to use its access authority to conduct individual contract audits in an effort to detect abuses and errors in the negotiation process. During the first several years after conferral of the access right, GAO employed the access-to-records statute exclusively to audit cost-reimbursement contracts to determine whether accurate cost information had been provided in negotiating the contract and in making claims for

payment. *See* Roback, *Truth in Negotiating: The Legislative Background of P.L. 87-653*, 1 Pub. Contract L.J. 3, 3 n.7 (1968). As recently as 1974 and 1975 (the only years for which there is information in the record), GAO was using its access authority exclusively to conduct individual audits of cost-based contracts in order to determine the accuracy of cost and pricing data supplied to government procurement officers during the negotiation of the contracts. (J.A. 21a-23a, 46a). Thus, denial of access to indirect cost records in connection with non-cost-based, fixed-price contracts will not have any impact on GAO's ability to conduct the kinds of audits on which it has concentrated its energy—except in aberrational episodes like the one now before the Court. The government's protest that the decision below will hamstring GAO flies in the teeth of GAO's own consistent administrative practice.

Statements of former Comptroller General Staats also belie the claims, now advanced by the government on his successor's behalf, that access to records of Merck's indirect costs are necessary to discharge GAO's statutory responsibilities. Prior to the issuance of the access demand to Merck, Staats assured Congress that the government's interest in "getting good prices" is protected when the government purchases drugs at or below the manufacturer's catalog price, because the pharmaceutical companies "have to meet their competition in the commercial market, which represents 95 percent of the business." *Hearings on Competitive Problems in the Drug Industry Before the Subcommittee on Monopoly of the Senate Select Committee on Small Business, supra*, 8580-81. His candid testimony also emphasized the difficulties posed by attempting to assign indirect costs to particular products and dismissed Senator Nelson's invitation to use the access authority in an attempt to allocate indirect costs to individual drug products as "a waste of time." *Id.* at 8573, 8578.

Finally, the decision of the court of appeals does not impede GAO's ability to meet its statutory responsibilities with respect to the four Merck contracts at issue here. GAO is free to seek access to those records necessary to determine that the contracts were properly negotiated on the basis of Merck's catalog price and to confirm that Merck was paid the amount called for in the contracts. An examination of those records would even suffice to establish the "reasonableness" of the contract price, since Congress has determined that the government is adequately protected when it procures products at or below the price established by the market for standard commercial items. *See* 10 U.S.C. § 2306(f).

II. NO COST RECORDS ARE DIRECTLY PERTINENT TO THE NON-COST-BASED, FIXED-PRICED CONTRACTS INVOLVED IN THIS CASE.

Although the court of appeals correctly held that Merck's indirect costs are outside the scope of the Comptroller General's access-to-records authority, it erred in affirming the portion of the judgment of the district court that authorized GAO to examine Merck's direct production costs. The language of the statute, its legislative history, and related procurement statutes adopted by Congress establish that Merck's direct production costs are not relevant to the non-cost-based, fixed-price contracts involved in this case.

A. Production Costs Are Not Directly Pertinent To Non-Cost-Based, Fixed-Price Contracts Negotiated On The Basis Of Commercial Market Factors.

When the words of limitation adopted by Congress are applied to the specific type of procurement contract involved in this case, the correct conclusion is that no cost records come within the scope of GAO's access-to-records

authority. As the government has acknowledged, there was no actual negotiation of price with respect to the four contracts; no cost or pricing data were requested by the government purchasing agency; and Merck made no representations about its costs in quoting its price for each product. Instead, unlike most negotiated government contracts, the contract prices here were established on the basis of the contractor's published catalog prices at which these standard commercial items were sold to the public, or on the basis of other evidence of adequate price competition. *See* pp. 6-7, *supra*. In these circumstances, Merck's production costs do not "directly pertain" to the contract because they were irrelevant to the negotiation of the contract or to a determination that the contract was performed in accordance with its terms.

As explained above, the access-to-records provision had its origin in emergency legislation designed to permit hard-pressed defense contractors to have their contract prices adjusted "to cover the advanced prices that [they had] to pay for labor and/or the raw material." 96 Cong. Rec. 17123 (1951) (remarks of Rep. Celler). The access authority was intended to deter abuse of this process by contractors who supplied inflated or inaccurate cost information to the government in seeking price adjustments. In the non-cost-based, fixed-price contracts involved in this case, there is no danger of such abuse of the negotiation process.[22]

[22] This interpretation is fully consistent with the purpose of the statute. The government argues that Congress intended to bring a "carefully crafted equilibrium . . . to the negotiation process" (Gov. Br. 33) and to eliminate "inequality of bargaining" (Gov. Br. 37). These observations, however, only support a right to access for those records that relate to the representations made by the contractor during the negotiation process. If the contractor does not base his proposed price on claims about his costs and if the price is not dependent on costs, "equilibrium" and "equality" in bargaining do not justify GAO access to cost data. *See* pp. 43-45, *infra*.

In concluding that GAO has authority to demand access to records of Merck's direct production costs, the district court relied exclusively on the decision of the Ninth Circuit in *Hewlett-Packard Co. v. United States,* 385 F.2d 1013 (9th Cir. 1967), *cert. denied,* 390 U.S. 988 (1968). (Pet. App. 36a-38a). The *Hewlett-Packard* decision, however, rests on a clearly erroneous reading of the statutory language that should not be followed by this Court.

In *Hewlett-Packard,* the Ninth Circuit sensibly recognized that if "costs were not taken into consideration in arriving at the terms and conditions of the contracts in question," and if the proper focus is the specific terms and conditions of the contract that gave rise to the access demand, then records relating to costs "could not be said to directly pertain to, and involve transactions relating to, the [non-cost-based] contract, as so defined." 385 F.2d at 1016. The Ninth Circuit went astray, however, by adopting a strained and unnatural definition of the term "contract." *See id.* The court inexplicably interpreted "contract" as "embracing not only the specific terms and conditions of the agreement, but also the general subject matter"—"the procurement of described property by the government." *Id.* This error improperly expanded the category of information the court considered "directly pertinent to" the "contract."

It is a fundamental canon of statutory construction that, "unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning." *Summit Valley Industries v. Local 112, United Brotherhood of Carpenters and Joiners,* ___ U.S. ___, ___, 50 U.S.L.W. 4560, 4561 (No. 81-497, decided June 1, 1982). The term "contract" has traditionally and commonly been understood to refer to a specific agreement between two parties. *See, e.g., Fletcher v. Peck,* 10 U.S. (6

Cranch) 87, 136 (1810). Significantly, this same, commonplace definition of contract was contained in federal procurement regulations in force at the time Congress enacted the access-to-records statute in 1951, 32 C.F.R. § 400.201(6) (1951), and continues to be used in the regulations in force today, 41 C.F.R. § 1-1.208 (1981).

This ordinary meaning of "contract" is reinforced here by the manner in which the term "contract" is used elsewhere in the same section of the statute. The mechanism employed by Congress in creating the access-to-records authority was to require the inclusion of an access clause in all "*contracts* negotiated without advertising." Act of October 31, 1951, Pub. L. 82-245, 65 Stat. 700 (emphasis added). There can be no doubt that the word "contract" was employed in that phrase to mean a specific, formal agreement between two parties, since only such agreements contain "clauses" and are subject to negotiation. Since it "is hardly credible that Congress used the term . . . in different senses in the same sentence," *United States v. Cooper Corp.*, 312 U.S. 600, 606 (1941), it is clear that "contract" as used in the access-to-records statute refers to the specific agreement between two parties.

Given this "ordinary meaning" of the term "contract," it is clear that the Ninth Circuit's initial assessment in *Hewlett-Packard* was the correct one: if "costs were not taken into consideration in arriving at the terms and conditions of the contracts in question," then records relating to costs "could not be said to directly pertain to, and involve transactions relating to, the contract." 385 F.2d at 1016.

B. Related Procurement Legislation Confirms That Cost Records Are Not Directly Pertinent To Merck's Non-Cost-Based Contracts.

Throughout the procurement system established by Congress to protect the government against unreasonable

or excessive prices, the type of negotiated contract involved in this case has been exempted from review of cost data. Although these related statutes do not directly control the interpretation of the access-to-records statute, it is sensible to give the comprehensive procurement statutes a coherent, consistent construction. These related statutes provide substantial evidence that Congress does not consider cost records to be "directly pertinent" to non-cost-based contracts that are priced on the basis of commercial market forces.

Congress enacted the access statute against the backdrop of the Renegotiation Act, 50 U.S.C. App. §§ 1211 *et seq.* Under that legislation, Congress established a Renegotiation Board charged with the responsibility for eliminating excessive profits earned on contracts between defense contractors and the United States. 50 U.S.C. App. §§ 1211, 1217. Contractors were required to submit to the Board financial statements detailing receipts, costs, and profits and to permit the Board to audit their books and records as part of the process for detecting excessive profits. 50 U.S.C. App. § 1215(e). Significantly, however, Congress exempted government contracts involving "standard commercial articles" from those requirements, *see* 50 U.S.C. App. § 1216(e)(1)(A), because "it is presumed that the prices which prevail on the open market place are fair prices, and do not involve excessive profits." 99 Cong. Rec. 10272 (1953) (remarks of Senator Milliken). This exemption is of particular significance here, because the legislative history of the access-to-records statute links GAO's access authority and the renegotiation process. *See* p. 23, *supra; see also* 32 Comp. Gen. 277, 278 (1952) (noting the relationship between the access-to-records provision and the Renegotiation Act of 1951).

The next important, related statute is the Truth-In-Negotiation Act, enacted in 1962. This legislation requires

contractors to submit actual or estimated cost and pricing data to the government as part of the negotiation of the contract price. 10 U.S.C. § 2306(f). The statute also grants the government the authority to make adjustments in the price paid if the contractor has submitted incomplete or outdated cost or pricing data. *Id.* "The goal of the Act is to place the contracting parties in a position of equality at the bargaining table" and "to avoid situations in which inaccurate, incomplete, or noncurrent information is known by the contractor, but withheld from the Government to its detriment." 1 R. Nash & J. Cibinic, *Federal Procurement Law* 383, 387 (3d ed. 1977).

Congress, however, expressly exempted the type of contract involved in this case—contracts negotiated on the basis of the established catalog price for a standard commercial item or on the basis of other indicia of adequate price competition—from the obligation to submit cost and pricing data to the procuring agency. 10 U.S.C. § 2306(f). Because the basic goal of the Act is to ensure that government contracting officers have all relevant data at the time of negotiation, the express exemption of non-cost-based contracts from the requirement of submitting cost data indicates that cost information is not "directly pertinent" to this type of contract.

In 1968, Congress amended the Truth-in-Negotiation Act to provide the purchasing agency with a right of access to the contractor's books and records in order to carry out post-performance audits. Pub. L. 90-512, 82 Stat. 863. Under the 1968 amendments, non-cost-based contracts also are excluded from the purchasing agency's post-audit access-to-records authority. Hearings on the 1968 legislation show that the amendment was designed to provide the purchasing agency with "the same type of access to records that the Congress has now made available to the General Accounting Office." *Hearings on the Review of Defense Procurement Policies, Procedures and Practices*

Before the Subcommittee for Special Investigations of the House Armed Services Committee, 90th Cong., 1st Sess. 61 (1967) (testimony of John M. Malloy, Deputy Assistant Secretary of Defense).

Finally, Congress in 1970 passed legislation establishing a five-member Cost Accounting Standards Board to promulgate uniform accounting standards that would be applied by all major government contractors. Pub. L. 91-379, 84 Stat. 796 (codified at 50 U.S.C. App. § 2168). The standards do not apply, however, to sales by a contractor "where the price negotiated is based on . . . established catalog or market prices of commercial items sold in substantial quantities to the general public." 50 U.S.C. App. § 2168(g).

Thus, Congress consistently has manifested its view that cost information is not "directly pertinent" to the negotiation and performance of non-cost-based contracts negotiated on the basis of the price prevailing in the commercial market. There is every reason to interpret GAO's access statute as embodying the same concept.

III. THE ACCESS DEMAND ISSUED TO MERCK CONSTITUTES A MISUSE OF THE ACCESS-TO-RECORDS STATUTE.

In *United States v. LaSalle National Bank*, 437 U.S. 298, 308 (1978), this Court recognized the principle that is controlling here: a court will not enforce an agency's demand for access to private records unless the demand is "in good-faith pursuit" of "congressionally authorized purposes." An agency that is given power for one purpose may not employ that power to pursue distinctly different, unauthorized goals, nor may an assertedly proper purpose be used as a pretext for a clearly improper one.

The General Accounting Office, like the Internal Revenue Service, "does not enjoy inherent authority to summon production of the private papers of citizens. It

may exercise only that authority granted by Congress." *United States v. LaSalle National Bank, supra,* 437 U.S. at 316-17 n.18. In determining whether an agency is acting in pursuit of "congressionally authorized purposes," the courts "should seek an affirmative grant of . . . authority . . . in the [statute] or its legislative history." *Id.* at 308, 316 n.18.[23] Application of these principles demonstrates that the Comptroller General's 1974 demand for access to Merck's records should be invalidated as an abuse of his statutory authority.

A. The Demand For Access To Merck's Records Was Issued To Obtain Financial Information For Individual Congressmen And To Gather Data For An Industry-Wide Economic Study.

As noted in the Statement, the August 1974 access-to-records demands served on Merck and five other pharmaceutical companies are unprecedented. In the more than twenty years since enactment of the access-to-records statute in 1951, GAO had never attempted to use the statute to conduct a broad-based economic study. *See* pp. 7-8, *supra.* The unique nature of the 1974 access-to-records demands issued to Merck and the other pharmaceutical companies is explained by their unusual origin. The motivating force behind the demands was persistent pressure applied by two Senators and their staff aides who desired to obtain cost data on individual drug products and who ultimately overrode the Comptroller General's own judgment that, from GAO's standpoint, the venture would be a "waste of time." *See* pp. 3-5, *supra.*

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[23] Although GAO is an independent agency within the legislative branch rather than an executive branch agency, the same basic principles govern its exercise of authority granted by Congress to require production of private business records. *See* Comment, *The Comptroller General's Authority to Examine the Private Business Records of Government Contractors: Eli Lilly & Co. v. Staats,* 92 Harv. L. Rev. 1148, 1154-57 (1979).

As the Third Circuit recently found in *SmithKline*, in the face of this pressure "GAO finally concluded that it had 'no viable alternative than to press the companies for access to their cost data.' " 668 F.2d at 203.[24]

Comptroller General Staats, who advised Congress of his belief that it would be impossible to develop meaningful cost data on an individual product basis, responded by proposing a general study of the economics of the pharmaceutical industry. GAO received voluntary cooperation in the first phase of this study from Merck and the five other pharmaceutical companies. Voluntary efforts broke down only when GAO, at the behest of the two Senators, declined to guarantee confidentiality of the companies' cost data. *See SmithKline v. Staats, supra,* 668 F.2d at 203 ("GAO's sole reason for abandoning its voluntary program and resorting to formal demands was the Senators' refusal to approve any assurances of confidentiality."). The Comptroller General then sought to placate the Senators and to gather the data necessary to complete his economic study by issuing the August 1974 access demands to the six companies that had come forward voluntarily to participate in the initial phase of GAO's study of the pharmaceutical industry.

B. The Comptroller General's Demand Was Not Made For A Congressionally Authorized Purpose.

The government does not contend in its opening brief, and has never contended in this litigation, that Congress authorized the Comptroller General to demand access to the records of private companies in order to secure private financial data desired by individual Members of Congress. Nor does the government claim that Congress authorized the Comptroller General to require private companies to make cost data available to the GAO

[24] The language quoted in the *SmithKline* opinion is from a GAO memorandum that is reprinted in the Joint Appendix at 146a-147a.

to facilitate its research studies. Not only are there no indications of an affirmative grant of such authority in either the language of the statute or in the legislative history, but such a broad-ranging visitorial power is plainly inconsistent with the limitations Congress carefully built into the 1951 access-to-records provision. *See* pp. 21-31, *supra.*

Instead of acknowledging that these two clearly unauthorized purposes underlie the access demand, the government asserts that the demand was issued "to determine the adequacy of the protection afforded the Government by the negotiation techniques used by the procuring agencies." (J.A. 45a); *see* Gov. Br. 17-18. The record makes clear, however, that this proferred purpose is merely a *post hoc* rationalization. A GAO memorandum written shortly after the issuance of the 1974 demand letters acknowledges GAO's actual purpose—"to present a report similar to that which we had proposed to present under the April 1974 proposal." (J.A. 154a-155a). It is hardly surprising that disinterested commentators have concluded that the purpose put forward by GAO in this litigation "was a mere pretext," Note, *Eli Lilly & Co. v. Staats: An Undue Expansion of the GAO's Investigatory Power Under the Access-to-Records Statutes, supra,* 74 Nw. U.L. Rev. at 129, and that "the sequence of events leading up to the demand letters" indicates "that an industry survey was the *sole* objective of the demand." Comment, *The Comptroller General's Authority to Examine the Private Business Records of Government Contractors: Eli Lilly & Co. v. Staats, supra,* 92 Harv. L. Rev. at 1152 (emphasis added).

Even assuming that the pretextual purpose asserted by the GAO actually motivated the demand, it is clear that the demand served on Merck was not issued for a congressionally authorized purpose. As we have explained above, the access-to-records statute was enacted to

enable GAO to conduct individual contract audits "as a deterrent to improprieties in the negotiation of Government contracts." 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy); *see* pp. 21-27, *supra*. In view of the origin of the access authority and the limits placed on it, it is evident that Congress did not intend to authorize GAO to use the access statute as a means of refining procurement techniques. The initial access-to-records provision contained in the First War Powers Act amendments was confined to a narrow class of contracts—those defense contracts that required modification as a result of inflation spawned by the Korean War. In addition, the legislation was limited by its terms to the duration of the national emergency declared on December 16, 1950, and was to expire in any event within 18 months. *See* Act of January 12, 1951, § 2, 64 Stat. 1258. Because the legislative history as well as GAO's contemporaneous statements establish that the purpose of the permanent access authority was to be the same as that of the First War Powers Act provision on which it was patterned (*see* pp. 24, 32-33, *supra*), there is no basis to believe that Congress was authorizing the GAO to demand access to confidential business records in order to study the general effectiveness of procurement techniques.[25]

There is nothing in the legislative history that reveals the slightest intention to allow the Comptroller General to use the access power to study the general adequacy of government procurement procedures. In the absence of evidence of an "affirmative grant" of authority to use the access statute to perform economic studies or to assess

[25] The two amendments added on the House floor limiting GAO to "directly pertinent" records and requiring that the access right be exercised within the three-year period provided for the audit of the accounts of government contracting officers are fundamentally at odds with the purported purpose now proferred by the government.

procurement techniques—and in view of the compelling evidence that Congress did not contemplate such a use of the statute—GAO's 1974 demand for Merck's records fails to satisfy the governing standard established by this Court in *LaSalle National Bank*. Moreover, since the assessment purpose proferred by the government is merely pretextual, the demand also fails to meet the "good faith" test of *LaSalle National Bank*. 437 U.S. at 313-14, 316. Because the Comptroller General's August 1974 access demand exceeded his statutory authority and constitutes a misuse of the access-to-records provision, there is an independent ground for holding that GAO is not entitled to examine any of Merck's cost records.

CONCLUSION

The judgment of the court of appeals should be affirmed insofar as it affirmed the grant of partial summary judgment in favor of Merck. To the extent that the court of appeals also affirmed the grant of partial summary judgment in favor of the government, it should be reversed, and the case should be remanded to the district court with instructions to enter summary judgment denying the Comptroller General access to Merck's records.

Respectfully submitted.

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Petitioner's Reply Brief

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CHARLES A. BOWSHER, COMPTROLLER GENERAL OF THE UNITED STATES, AND UNITED STATES OF AMERICA, PETITIONERS

v.

MERCK & CO., INC.

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v.

CHARLES A. BOWSHER, COMPTROLLER GENERAL OF THE UNITED STATES, AND UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS IN NO. 81-1472 AND REPLY BRIEF FOR THE PETITIONERS IN NO. 81-1273

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In the Supreme Court of the United States

OCTOBER TERM, 1982

No. 81-1273

CHARLES A. BOWSHER, COMPTROLLER GENERAL OF THE UNITED STATES, AND UNITED STATES OF AMERICA, PETITIONERS

v.

MERCK & CO., INC.

No. 81-1472

MERCK & CO., INC., PETITIONER

v.

CHARLES A. BOWSHER, COMPTROLLER GENERAL OF THE UNITED STATES, AND UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS IN NO. 81-1472 AND REPLY BRIEF FOR THE PETITIONERS IN NO. 81-1273

SUMMARY OF ARGUMENT

Our opening brief demonstrated that when Congress empowered the Comptroller General to examine a government contractor's books and records, it intended to invest him with a meaningful tool for monitoring federal procurement. In particular, the access-to-records provisions stemmed from the congressional determination that negotiated contracts "require close supervision and control." H.R. Rep. No. 791, 82d Cong., 1st Sess. 2 (1951). To this end, Congress granted broad authority to the Comptroller General to investigate negotiated procurements so

that waste, extravagance, inefficiency and impropriety could be detected and remedial recommendations made.

Merck's scattershot opposition to the exercise of the Comptroller General's statutory authority is entirely misplaced. The contentions Merck advances would bar the Comptroller General from access to virtually all of its documents, a result clearly at odds with the legislative purpose.

I

A. Merck's argument reflects a fundamental misunderstanding of the procurement process and of the General Accounting Office's role in that process, as consistently interpreted by the Comptroller General. If Merck's views prevail, the broad powers to investigate the efficiency and economy of government procurement that Congress conferred upon the Comptroller General would be destroyed. Instead, GAO would be limited to performing the essentially ministerial task of reviewing accounts payable solely for mathematical accuracy—a task already performed by the contracting agency.

B. The exemptions Merck would engraft onto the access provisions have no basis in the statutory language. Although the relevant provisions grant access to records of "all" negotiated contracts (see, *e.g.*, 41 U.S.C. 254(c)), Merck would exclude fixed-price negotiated contracts and would preclude access for any purpose other than the detection of fraud. Lacking support for these "implied exemptions" in the statute itself, Merck relies instead on a myopic view of the legislative history. Thus, Merck quotes portions of the congressional debates that identify prevention of fraud as one of the intended purposes, yet it omits reference to the "vast majority" of comments that make clear that other purposes—such as those underlying the present request—were equally a part of Congress' intent.

C. The specific request for access at issue here was patterned on the request upheld in *Hewlett-Packard Co.* v. *United States*, 385 F.2d 1013 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968), and was designed to fulfill

GAO's oversight role in the government procurement process. Accordingly, the request was, by its terms, bound by the express limitations set forth in the statutes: it was made within three years of final payment, it sought documents directly pertaining to specific government contracts, and it sought no technical information, records relating exclusively to other products, or unrelated corporate planning data.

Although GAO's request complied in every respect with the access-to-records provisions, Merck opposes production of any documents. At the heart of its argument is the contention that, because its internal accounting system fails to allocate more than 90% of its costs, those costs are by definition not directly pertinent to the government's contracts. The flaw in this argument is that the definition is Merck's, not Congress'. And, as this Court held in *Exxon Corp.* v. *Department of Revenue of Wisconsin*, 447 U.S. 207, 226 (1980), the government is not bound by the manner in which a corporation chooses to maintain its accounts.

If GAO is restricted to data of only 9% of Merck's costs, as the court of appeals held, it will be unable to conduct any meaningful studies or produce any meaningful results. As a consequence, the "legislative purpose of reducing waste in government procurement" will be "undermined severely." Pet. App. 25a (Mikva, J., concurring in part and dissenting in part).

II

Relying on a selective quotation of GAO statements, Merck argues that the Comptroller General previously has construed the access-to-records provisions more narrowly than he does in this case. Merck's reasoning is flawed.

First, Merck assumes that when GAO mentions certain purposes served by the records access provisions, any other purposes not expressly mentioned are sub silentio negated. This is plainly incorrect, as demonstrated by our discussion of the legislative history and GAO's consistent interpretation for more than 30 years.

Merck also relies on several GAO memoranda that related to situations wholly unlike this case. Evidence that GAO in the past has rejected proposals for studies that bore no relation to government contracts or that went far beyond the present request for records hardly suggests that the modest proposal at issue here is unauthorized. To the contrary, this history indicates that the Comptroller General is sensitive to the limits on his powers and that he has consistently exercised those powers only to satisfy his statutory obligations.

III

GAO requested the documents in this case to review the reasonableness of prices paid by the government and the adequacy of the government's procurement methods. Contrary to Merck's assertions, examination of these records will not result in a wholesale intrusion on the private sector. Merck will remain entirely free to maintain its chosen accounting methods and pricing policies. The only result of GAO's inspection will be a review of the buyer's side of the transactions so that, if indicated, recommendations may be made for improvements in government procurement.

IV

Merck's final argument, that the Comptroller General's request for records was motivated by an "improper" purpose, has been squarely rejected by every court that has considered it. The contention is premised on a misreading of the facts and a misconception of the study GAO proposes to conduct. In any event, the courts below found that GAO's purpose was proper and authorized by statute.

ARGUMENT

I. THE LIMITATIONS MERCK WOULD ENGRAFT ONTO THE ACCESS PROVISIONS HAVE NO BASIS IN THE STATUTORY LANGUAGE OR LEGISLATIVE HISTORY

As described in our opening brief, the access-to-records provisions involved in this case are broad grants of investigative authority to enable the Comptroller General

to make "meaningful examination[s] of the reasonableness of the prices charged to the Government." *Hearings on Comptroller General Reports to Congress on Audits of Defense Contracts Before the Subcomm. on Military Operations of the House Comm. on Government Operations*, 89th Cong., 1st Sess. 44 (1965) (remarks of Comptroller General Campbell); see Gov't Br. 17-30.[1] Merck's opposing arguments, which seek to limit the Comptroller General's access authority in a number of ways, ignore the express terms of the statutes, the legislative history and the consistent interpretations of the General Accounting Office. At the heart of Merck's position are three erroneous claims: that fixed-price contracts are exempt from the access-to-records provisions; that the provisions are limited to detection of fraud; and that the Comptroller General has no authority to study "the general adequacy of government procurement procedures" (Merck Br. 49).

A. Introduction—The Procurement Process

Merck's contention that the access-to-records provisions exempt the records sought in this case stems from a misunderstanding of the procurement process and the Comptroller General's role in that process. It is the contracting agency—in this case the Veterans Administration (VA) and the Defense Supply Agency (DSA) of the Department of Defense—that has primary contact with the contractor during the negotiation and performance of a government contract. Depending on the circumstances, the contracting agency may be authorized by statute and regulation to advertise its procurement needs and ask for sealed bids, or to proceed on a nonadvertised, negotiated basis, as occurred in this case. If the negotiation format is selected, the agency's contract-

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[1] "Gov't Br." refers to the Brief for the Petitioners in No. 81-1273. "Merck Br." refers to the Brief of Merck & Co., Inc. "AIAA Br." refers to the Brief Amicus Curiae of the Aerospace Industries Association of America, Inc. "C.A. App." refers to the joint appendix filed in the court of appeals.

ing officer may choose to enter into a fixed-price contract or a cost-type contract where payment is based on the contractor's incurred costs.[2] In either event the agency remains entitled, in many instances, to require, as part of the negotiation process, that potential contractors submit documentation reflecting cost and pricing information, including manufacturing costs.[3]

In order to monitor performance under the contract, the contracting agency is invested by statute and regulation with certain auditing powers over the contractor. These authorities permit the contracting agency to obtain access to a contractor's records for the purpose of evaluating the accuracy, completeness and currency of cost or pricing data submitted during negotiations and under cost-type contracts for the purpose of ensuring that claimed costs were actually incurred.[4]

Distinct from the process of contract negotiation and performance are the powers and responsibilities of GAO.[5] To be sure, one of GAO's functions is to

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[2] See Armed Services Procurement Act of 1947, 10 U.S.C. (& Supp. IV) 2301-2314, and 50 U.S.C. 403c; Federal Property and Administrative Services Act of 1949, 41 U.S.C. 251-260; 32 C.F.R. 3-404.2 and 3-405; 41 C.F.R. 1-3.404 and 1-3.405. (32 C.F.R. contains Defense Acquisition Regulations; 41 C.F.R. contains Federal Procurement Regulations.)

[3] See Truth in Negotiations Act, 10 U.S.C. (Supp. IV) 2306(f). Although this statute pertains only to military procurements, the basic provisions of the statute have been extended to civilian procurement by regulation. See 41 C.F.R. 1-3.807-1, 1-3.807-2, 1-3.807-3, 1-3.814-2.

[4] Access to records relating to cost and pricing data is authorized by 10 U.S.C. 2306(f), 32 C.F.R. 7-104.41(c), and 41 C.F.R. 1-3.814-2(c). Access to records pertaining to cost-type contracts is provided for in 32 C.F.R. 7-104.41(b) and 41 C.F.R. 1-3.814-2(b).

[5] See, *e.g.*, H. Wright & J. Bedingfield, *Government Contract Accounting* 150 (1st ed. 1979) ("GAO's audit responsibility is much broader [than that of the contracting agency], usually being directed toward determining the economy and efficiency of the overall procurement process"); B.B. Lynn, *Contract Audits Under the Truth in Negotiations Act*, in *The Truth in Negotiations Act—A Machine and Allied Products Institute Symposium* 139, 154 (1969) ("A dis-

serve as a check on contracting agency audits so that the government has additional assurance that it has paid no more than the bargained-for price. But the Comptroller General's mandate is not confined solely to that function.[6] In addition, the Comptroller General is charged with oversight responsibilities for the entire procurement process as part of his duty to "investigate * * * all matters relating to the receipt, disbursement, and application of public funds" and to "make recommendations [to Congress] looking to greater economy or efficiency in public expenditures" (31 U.S.C. 53(a)).

A review of the VA and DSA procurement procedures involved in this case could include consideration of whether additional information, including cost records, should be required from companies at the negotiation stage, and whether fixed-price or cost-type contracts are

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tinction must be made between the objectives of GAO and the Defense Contract Audit Agency. The GAO's purpose in auditing includes a check on the efficiency of government procurement. As for DCAA, both the purpose and scope of its audits are narrower. An audit by DCAA of compliance with the requirements of Pub. L. No. 87-653 is concerned with ascertaining that the cost or pricing data which was available—and should have been submitted—by the contractor at the time of price negotiations, was submitted").

[6] See, *e.g.*, 31 U.S.C. 60; F.C. Mosher, *The GAO: The Quest for Accountability in American Government* 318 (1979):

> For many years, the main "entree" in the GAO's work menu was the audit of individual procurement contracts, particularly in the area of defense. This is no longer the case. Since the Defense Department established the [DCAA] in 1965, the bulk of defense auditing has been carried out by the Defense Department itself. * * * Somewhat comparable audit operations are carried on within the various civilian departments. The GAO audits a very limited sample of contracts annually, primarily to identify and evaluate the efficiency and effectiveness of procurement policy, pricing, controls, and auditing. Its focus is not upon individual contracts or contractors but upon the effectiveness of the systems and criteria whereby contracts are negotiated, carried out, and audited by the executive agencies. Its aims are primarily to develop and make recommendations for improvements in the process, not to seek out individual culprits.

a more appropriate means of fulfilling the government's particular procurement needs.[7] It is thus the process itself—not the performance of any particular contract—to which GAO directs its inquiry, focusing on possible recommendations to increase efficiency and economy in public expenditures.

B. Fixed-Price Contracts Are Not Exempt From GAO's Oversight Functions Under The Access-to-Records Provisions

Among the tools Congress provided to the Comptroller General for performing the obligations of his office are the access-to-records provisions involved in this case (10 U.S.C. 2313(b); 41 U.S.C. 254(c)). The enactment of these provisions in 1951 conferred upon the Comptroller General broad statutory authority to scrutinize federal procurement by obtaining records from government contractors.[8]

The sponsor of the legislation, Representative Hardy, commented that this investigative authority would act as a "safeguard against waste and extravagance" in government procurement. 97 Cong. Rec. 13198 (1951). These powers were regarded as particularly important in the context of negotiated contracts. More so than advertised procurements, which were deemed to have inherent competitive safeguards, "negotiated contracts * * * require close supervision and control * * *." H.R. Rep. No. 791, 82d Cong., 1st Sess. 2 (1951); S. Rep. No. 603, 82d Cong., 1st Sess. 2 (1951).

For these reasons, Congress required that *all* negotiated contracts (in excess of a prescribed dollar amount,

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[7] The record reveals that there was no negotiation of price in connection with the contracts involved in this case; Merck's proposals were accepted as submitted and no cost data was requested or obtained. J.A. 42a. See Pet. App. 11a n.14.

[8] Merck's contention (Merck Br. 21-23, 31) that the records access provisions should be narrowly construed because they are derived from temporary emergency legislation is misplaced. In 1951 the statutes were made permanent, and it is under these permanent powers that the request for records issued in this case (see Pet. App. 16a-17a).

see Pet. 7 n.7) contain access-to-records provisions to enable the Comptroller General "to do the job the Congress has instructed him to do * * *." 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy). The statutes do not exempt fixed-price contracts, as Merck contends (Merck Br. 39-45), and for good reason. The Comptroller General's responsibilities are broader than merely assuring the accuracy of governmental accounts payable; they include the prevention of "fraud and extravagance and waste and all those things" [9] and protecting against "the Government * * * com[ing] out on the short end of the deal." [10] Accordingly, scrutiny of procurement methods in negotiated fixed-price contracts is an essential component of GAO's oversight, because such contracts involve the same risks of excessive prices or uneconomical procurements as do any other types of negotiated contracts.

Moreover, had Congress intended to exempt fixed-price contracts,[11] it is reasonable to conclude that such a major restriction would have been expressed in the statute.[12]

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[9] 97 Cong. Rec. 13373 (1951) (remarks of Rep. Hoffman). See *id.* at 13198, 13373 (remarks of Reps. Hardy and Church).

[10] 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy).

[11] Fixed-price contracts are the preferred method of procurement. Indeed, Congress has specified that "cost" and "cost-plus-a-fixed fee" contracts cannot be let without a determination by the head of the contracting agency that it is "likely to be less costly to the United States than any other kind of contract." 10 U.S.C. 2306(c). See 41 U.S.C. 254(b); 32 C.F.R. 3-405.1; 41 C.F.R. 1-3.405-1.

[12] Merck and amicus Aerospace Industries Association of America contend (Merck Br. 42-44; AIAA Br. 10-17, 25-26) that this limitation should be implied because other procurement statutes contain express exemptions from the requirement to submit cost data in contracts of the type involved here. Thus, Merck and AIAA point to the exclusion of "standard commercial articles" from the Renegotiation Act, 50 U.S.C. App. 1216(e)(1)(A), and the exclusion of catalog price items from the Truth in Negotiations Act, 10 U.S.C. (Supp. IV) 2306(f). This argument is misplaced. In fact, these other statutes serve to prove our point that when Congress intended specific exemptions it expressly so provided. See *SmithKline Corp.*

As this Court has observed, "Congress knew the significance and meaning of the language it employed" (*Barrett* v. *United States*, 423 U.S. 212, 217 (1976)) and "[a]bsent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive" (*CPSC* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)).

These fundamental principles of statutory construction have persuaded every court that has considered the issue to reject the implied exemption argument Merck propounds. *Hewlett-Packard Co.* v. *United States*, 385 F.2d 1013, 1016 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968); *Eli Lilly & Co.* v. *Staats*, 574 F.2d 904, 916 (7th Cir.), cert. denied, 439 U.S. 959 (1978); *SmithKline Corp.* v. *Staats*, 668 F.2d 201, 208 (3d Cir. 1981), petition for cert. pending, No. 81-2082 (filed May 10, 1982). See also Pet. App. 17a-18a (Mikva, J., concurring in part and dissenting in part).

C. The Access-to-Records Provisions Are Not Limited to Detection of Fraud

Merck contends (Merck Br. 21-27) that the records access provisions were designed exclusively to detect fraud or to uncover information relevant to the renegotiation of contracts under the Renegotiation Act, 50 U.S.C. 1211 *et seq.* Building on this premise, Merck argues that be-

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v. *Staats*, 668 F.2d 201, 208 (3d Cir. 1981), petition for cert. pending, No. 81-2082 (filed May 10, 1982). Moreover, if Merck and AIAA mean to argue, as they apparently do, that GAO may use the access-to-records provisions only to obtain data available to the government through other means, the consequence would be total nullification of congressionally created powers.

AIAA's further argument (AIAA Br. 15 n.33) that the varying language in other access statutes sets limits on the powers granted in the subject provisions is erroneous. Despite AIAA's assertion, some of the cited statutes in fact use the words "directly pertinent" (*e.g.*, 42 U.S.C. (Supp. IV) 8745). The remainder relate either to access to records of government agencies (*e.g.*, 31 U.S.C. (Supp. IV) 54(a)) or to federal programs for grants, subsidies, or assistance. None relates exclusively to procurement and some expressly exclude procurement contracts (*e.g.*, 20 U.S.C. (Supp. IV) 1232f(b)).

cause the government does not suspect fraud (and because the contracts are not subject to the Renegotiation Act), the Comptroller General lacks authority under the access provisions to obtain the records requested in this case. This contention is without merit.

The access-to-records statutes, of course, contain no such language of limitation, and one need inquire no further to reject Merck's interpretation. Nevertheless, we address Merck's analysis of the legislative history because that history demonstrates that Congress clearly intended to create a meaningful tool for monitoring federal procurement practices—a purpose far broader than, though including, detection of fraud.

In support of its conclusion, Merck points to several fragments of the legislative history that evidence Congress' concern with fraud and profiteering and its desire to curb such abuses. With this, we have no disagreement. There is no dispute that such issues were paramount in the congressional debates. Where we part company with Merck's analysis is its misconception that *part* of Congress' purpose was its *sole* purpose. See, *e.g.*, *United States* v. *Naftalin*, 441 U.S. 768, 774-775 (1979); *United States* v. *Culbert*, 435 U.S. 371, 377 (1978). As the Third Circuit has recognized (*SmithKline* v. *Staats*, *supra*, 668 F.2d at 205 (citations omitted; emphasis added)):

> The provisions were certainly intended to authorize access to records in cases of suspected fraud and profiteering. Nevertheless, given that such was the primary concern, it does not necessary follow that no other purposes for the provisions exist. There is a fine line between profiteering and wastefulness, and *the vast majority of the legislative references to the provisions do not indicate an intent to restrict their use to situations involving impropriety.*

Indeed, the "vast majority" of references in the legislative history demonstrate that Congress affirmatively considered, and authorized, the use of these provisions as a broader investigative power. Representative Hardy

expressly addressed this issue when he stated that deterring waste was one of the "major purposes" of the legislation and that Congress "clearly understood * * * that there are a lot of other situations besides those involving fraud which might be uncovered." 97 Cong. Rec. 13198, 13199 (1951). See *id.* at 13198 (remarks of Rep. Hardy) (the provisions would act as a "safeguard against waste and extravagance"). Similar views were voiced by Representatives Hoffman and Church. *Id.* at 13373 (remarks of Rep. Hoffman) ("GAO is * * * the most effective agency we have against fraud and extravagance and waste and all those things"); *ibid.* (remarks of Rep. Church) (legislation "is necessary in the interest of integrity or economy").

Once again, Merck's attempt to imply a limitation in the statutes' unqualified language is inconsistent with the legislative history and purpose and, accordingly, has been uniformly rejected by the lower courts. See *Hewlett-Packard Co.* v. *United States*, *supra*, 385 F.2d at 1016; *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 914-915; *SmithKline Corp.* v. *Staats*, *supra*, 668 F.2d at 208. See also Pet. App. 8a-14a (Mikva, J., concurring in part and dissenting in part).

D. The Powers Created By Congress Include Access To The Documents Requested in This Case

1. As Judge Mikva recognized, the remainder of Merck's contentions on the scope of access "can be traced to Merck's argument that the access legislation was designed merely to achieve 'a limited anti-fraud purpose.'" Pet. App. 17a. In Merck's view, simply because the government contracted to purchase pharmaceuticals at fixed prices and required the submission of no cost data during the negotiations, its cost records are not "directly pertinent" to the contracts.[13] Thus, Merck proposes that so

[13] Merck does not expressly raise this issue with respect to any pricing data requested by GAO. Moreover, the record reveals that, with respect to one of the contracts, Merck supplied pricing data at the contracting officer's request during the negotiations. Affidavit of T.J. Drygas, ¶ 26 (C.A. App. 83-84).

long as the government can ascertain that it received the goods described in the contract and that it paid the specified amount—information that, obviously, is at the government's disposal without seeing any of a contractor's records or utilizing the access-to-records provisions—the government has exhausted its power under the access provisions. See Merck Br. 27, 39.[14]

This description of the Comptroller General's statutory authority, which renders the access provisions largely meaningless in a great percentage of government procurement cases, is attributable to Merck's myopic perception of GAO's role in the procurement process and of the tools Congress provided to pare waste and inefficiency from that process. In essence, Merck would limit the Comptroller General to the clerical task of checking that the amount of the government's payment squared with the balance due on the contract.[15] See notes 5 & 6, *supra*. But this view leaves no room for the Comptroller General's obligation to investigate whether the procurement methods themselves, and not simply the results of those methods in particular cases, adequately protect the government against unreasonable prices, waste and extravagance. To accomplish this task, GAO must neces-

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[14] Merck contends that it is required by statute and contract to produce only those records "required to verify (i) that the contractor actually had an established catalog price for the item procured, (ii) that the item was sold in substantial quantities to the general public at the catalog price, (iii) that the contractor delivered the product specified, and (iv) that the sum received in payment from the government was the correct amount due under the contract" (Merck Br. 27). But the limited information Merck would grudgingly produce was already subject to government examination. See Affidavit of T.J. Drygas, ¶¶ 20, 25 (C.A. App. 81, 83), which indicates that for two of the contracts Merck submitted form DD633-7. This form, on its face, grants to the government, for a three year period from final payment, "access to books, records, documents and other supporting data which will permit verification of the claim." In addition, much of the information Merck magnanimously has offered to produce is known to the government from its own records.

[15] Merck's limited expansion of this role—to permit review of catalog prices—does not materially enlarge GAO's access and by no means affords GAO its full statutory powers. See note 14, *supra*.

sarily make such inquiries as whether a fixed-price contract was a suitable means of fulfilling the particular procurement need, whether additional data or cost information should be required at the negotiation stage, and whether it is reasonable to assume in the context of the pharmaceutical industry that market factors provide sufficient competitive safeguards that a catalog price is reasonable.[16] Wholly apart from any ability to affect the procedures or prices involved in these contracts, the results of such an inquiry here could result in recommendations to the contracting agencies in the future. See *Hewlett-Packard Co.* v. *United States*, *supra*, 385 F.2d at 1016; *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 915. This function would be effectively negated if Merck's view prevails.

2. The specific request contained in the Comptroller General's letter of August 26, 1974 (J.A. 17a-19a) was designed to fulfill GAO's oversight role.[17] Accordingly, the request was limited to documents relating to specific government contracts and sought no records relating exclusively to other products. It was, moreover, limited to records of costs and pricing and sought no technical information or unrelated planning data. The decision below, however, curtails access so restrictively that the Comptroller General will be unable to obtain records sufficient to conduct a meaningful review of government procurement methods.

The court of appeals' decision limits access to records of approximately 9% of Merck's costs under the contracts

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[16] See Congressional Research Service, 92d Cong., 2d Sess., *Competitive Problems in the Drug Industry: A Summary Analysis and Discussion of Issues Based on Hearings Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business* 9-11, 27-29 (manufacturers seek to develop patentable products and retain significant market power long after patent expiration); M. Statman, *The Effect of Patent Expiration on the Market Position of Drugs* 8-13 (Nov. 15-16, 1979) (unpublished study prepared at Rutgers University for the American Enterprise Institute).

[17] This request was patterned on the request that was upheld in *Hewlett-Packard Co.* v. *United States*, *supra*. See *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 913.

at issue (see Gov't Br. 34-36). Any study built on such a sparse foundation will necessarily be flawed because any extrapolation from this sample would be highly speculative. In order to reduce the inherent subjectivity of such a process, it is essential that full cost records be provided.

Merck's primary response to this argument is that it does not allocate the bulk of its costs to individual products and deems any effort at such allocation to be "arbitrary" or "artificial." Merck Br. 19. This answer misses the point. While Merck is not required by generally accepted accounting principles to allocate all of its costs, neither do those principles dictate that more than 90% of its costs be maintained on an unallocated basis. Merck has chosen to arrange its financial affairs in this fashion for its own purposes, but, as this Court held in *Exxon Corp.* v. *Department of Revenue of Wisconsin*, 447 U.S. 207, 226 (1980), a corporation's selection of accounting methods does not bind the government. This fundamental principle is well suited to this case, because the plain import of Merck's position is that if it or any other government contractor chose to allocate *none* of its costs, the Comptroller General would not be entitled to see *any* records. In that event, the clear congressional purpose would be thwarted by unilateral action of the party whose dealings with the government Congress sought to monitor. Congress could not have intended such "anomalous results." *Department of State* v. *Washington Post Co.*, No. 81-535 (May 17, 1982), slip op. 6.

Merck's suggestion that the statutory term "directly pertinent" must be defined by Merck's method of accounting also is unsound because it incorporates an unduly narrow conception of costs of performance. Thus, Merck contends (Merck Br. 19) that its "direct" costs of production—which on the record in this case are essentially the same as its allocated costs, see Pet. App. 23a & n.24—are the only costs that may be considered "directly pertinent" to the contracts. Aside from the fact that, as Judge Mikva recognized (*id.* at 25a), the similarity in language does not reflect a substantive equiva-

lence between "direct costs" and "directly pertinent" records, Merck's use of the term "direct costs" does not in any meaningful sense set the boundaries of GAO's right to access.

Reduced to its essentials, Merck's argument (Merck Br. 15-19) is that its "indirect" costs (*i.e.*, research and development, marketing and promotion, distribution and administration)) "were generated as part of its overall costs of doing business" and "were not incurred as a result of the four government contracts involved in this case" (*id.* at 18). Therefore, Merck contends, these costs are not subject to characterization as "directly pertinent." This analysis defies business and economic realities. It would make as much sense to say that goods sold out of inventory give rise to *no* production costs because the expenses of manufacturing the products had previously been accounted for and no further costs were "incurred as a result" of a particular contract. "In terms of the statutory objectives," which Merck persistently misstates or ignores, Merck's "distinction makes little sense." *FBI* v. *Abramson*, No. 80-1735 (May 24, 1982), slip op. 12.

Finally, Merck's effort to confine the access-to-records provisions in the straitjacket of its internal accounting system must fail because that system is not so restrictive as Merck's brief would suggest. As we noted in our opening brief (Gov't Br. 38), Merck in fact allocates some otherwise "unallocated" costs for "internal management" purposes and uses these figures for "general information and trend data." This telling point, to which Merck makes no effective response, demonstrates the fanciful nature of the contention that any effort to apportion costs is destined to be "arbitrary" or "artificial." [18]

3. In the courts below, the government was denied access to Merck's unallocated costs. The basis for that cur-

[18] To the extent Merck believes that these internal "off books" allocations should be qualified, it is of course free to express those views to the Comptroller General when it produces the records. The point here is that Merck itself, when it suits the purposes of management, makes precisely the sort of calculations it regards as not "meaningful" (Merck Br. 19 n.11) when proposed by the government.

tailment of the Comptroller General's statutory authority does not, however, withstand analysis. We demonstrated in our opening brief (Gov't Br. 37 n.20) that the "compromise" that permits review of allocated costs while barring access to unallocated costs was derived from the drug company's description in *Bristol Laboratories* v. *Staats*, 428 F. Supp. 1388, 1389-1391 (S.D.N.Y. 1977), of documents it was *willing* to produce. In the present case, the district court adopted the *Bristol* approach, noting that it "appears to me a realistic interpretation of the intent of the parties * * *." Pet. App. 39a.[19] There was no further analysis, just as there has been none in any other decision that has adopted *Bristol's* volunteered compromise.

Rather, as Judge Mikva recognized, the *Bristol* compromise "defies reason" (Pet. App. 25a) and "undermine[s] severely" "the legislative purpose of reducing waste in government procurement" (*ibid.*). Similarly, the Third Circuit acknowledged in *SmithKline Corp.* v. *Staats*, *supra*, that the *Bristol* result "may make it more difficult in some cases for GAO to obtain the information it may *need* to uncover wastefulness," 668 F.2d at 213 (footnote

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[19] The meaning of the access-to-records clause does not rest on the understanding of the parties. The clause was statutorily required to be included in the contracts, and its content is necessarily determined by those statutes rather than by the parties' intentions (Pet. App. 27a-28a (Mikva, J., concurring in part and dissenting in part)). See, *e.g.*, *Federal Crop Insurance Corp.* v. *Merrill*, 332 U.S. 380, 383-385 (1947); *DeMatteo Construction Co.* v. *United States*, 600 F.2d 1384, 1391 (Ct. Cl. 1979); *Jackson* v. *United States*, 573 F.2d 1189 (Ct. Cl. 1978); *G.L. Christian and Associates* v. *United States*, 320 F.2d 345, 351 (Ct. Cl.), cert. denied, 375 U.S. 954 (1963); cf. *United States* v. *Wunderlich*, 342 U.S. 98, 100 (1951). In any event, if the parties' intent were relevant, Merck "must be charged with knowledge that the government read the access clause broadly in light of *Hewlett-Packard*." Pet. App. 28a n.30. In addition, GAO's public statements of its construction of the access provisions (see Gov't Br. 25-31) and the general recognition of GAO's position (*id.* at 23-24), put Merck on notice of GAO's interpretation and rebut any presumption that Merck had a contrary intent.

omitted, emphasis added), and that any study based on "such restricted data may be of limited utility" (*ibid.*).[20]

Having charged GAO with investigating "*all* matters relating to the receipt, disbursement, and application of public funds" and "mak[ing] recommendations looking to greater economy or efficiency in public expenditures" (31 U.S.C. 53(a) (emphasis added); see 31 U.S.C. 1154), it is inconceivable that Congress then provided access-to-records authority for studies of only "limited utility." To accept Merck's argument, in light of the legislative history set forth in our opening brief, " 'would be to impute to Congress a purpose to paralyze with one hand what it sought to promote with the other.' " *Weinberger* v. *Hynson, Westcott & Dunning*, 412 U.S. 609, 631 (1973), quoting *Clark* v. *Uebersee Finanz-Korp.*, 332 U.S. 480, 489 (1947); see *Texas & Pacific Ry.* v. *Abilene Cotton Oil Co.*, 204 U.S. 426, 446 (1907) ("the act cannot be held to destroy itself").

II. GAO'S INTERPRETATION OF THE ACCESS-TO-RECORDS PROVISIONS HAS BEEN CONSISTENT AND IS ENTITLED TO DEFERENCE

Our opening brief (Gov't Br. 25-31) recounts the Comptroller General's consistent interpretation of the access provisions in the three decades since their enactment. Merck's response (Merck Br. 7-8, 31-36) is historically inaccurate and, when understood in context, fails to identify a material difference between our argument and GAO's uniform construction and implementation of the statutes.

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[20] Although the court in *SmithKline* adopted the *Bristol* approach, it fully recognized that "if the access provisions were meant to equalize the relationship between the Government and private contractors, our reading of the clause fails to advance fully that purpose * * *." 668 F.2d at 213. We believe that *SmithKline* was wrongly decided on this issue because it was precisely Congress' intent to "equaliz[e] the relationship between more experienced contractors and government representatives, who were otherwise 'at a tremendous disadvantage' * * *." Pet. App. 11a (Mikva, J., concurring in part and dissenting in part). See 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy).

Merck relies on the fact that, in letters to Congress on an amendment to the War Powers Act,[21] GAO quoted Representative Celler's comment that the proposed legislation would permit GAO "to determine whether or not there is fraud or overreaching * * *". 96 Cong. Rec. 17123 (1951). That statement, which scarcely precludes the other salutary purposes of the legislation (see pages 11-12, *supra*),[22] does not foreclose GAO's access request in this case. Moreover, consistent with Congress' consideration of both the War Powers Act amendment and the records access statutes, GAO also commented that 10 U.S.C. 2313(b) and 41 U.S.C. 254(c) would be "a deterrent to those persons who might otherwise abuse the authority to negotiate certain contracts without advertising. * * * [A]ny abuses discovered by the General Accounting Office in exercising the authority contained [in the bill] promptly will be brought to the attention of the proper officials, and, if warranted, to the attention of the Congress." H.R. Rep. No. 791, 82d Cong., 1st Sess. 4-5 (1951); S. Rep. No. 603, 82d Cong., 1st Sess. 4 (1951).

Merck asserts that because, in 1974 and 1975, GAO audited only "cost-based" contracts (Merck Br. 34), the request at issue in this case is "unique" and "unprecedented" (*id.* at 7-8). The record is to the contrary. As indicated above, the contracts at issue in *Hewlett-Packard* were fixed-price, as were the contracts involved in GAO's survey of the HY 80 steel plate and tire industries (J.A. 47a).[23] See page 10, *supra*.

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[21] See Act of Jan. 12, 1951, ch. 1230, 64 Stat. 1257, amending 50 U.S.C. App. (1946 ed.) 611, repealed, Pub. L. No. 89-554, Section 8(a), 80 Stat. 651.

[22] Similarly, Merck's reference to the Comptroller General's 1955 annual report (Merck Br. 34) assumes that the statement in a particular document of one purpose—with no indicia of exclusivity—precludes all other purposes.

[23] Merck has contended that these and other reports identified in discovery proceedings differ from the current request in one or another particular. Despite this nitpicking, the fact remains that each challenged aspect of the instant request for records has been part of prior GAO inquiries.

Merck also contends (Merck Br. 35) that GAO has previously acknowledged its lack of authority to request records relating to a contractor's commercial business rather than to its contracts with the government. Read in context, however, both of the statements Merck cites (J.A. 162a-165a) simply reflect the unquestioned proposition that GAO has no independent authority directly to seek access to the records of a contractor's unrelated commercial, *i.e.*, non-government, activities. Nothing in these documents and testimony suggests that GAO is not entitled to commercial records where, as here, because the contractor has failed to segregate its costs, they are necessary for determining the adequacy of procurement methods and the reasonableness of the price set in a *government* contract containing an access-to-records clause.[24]

Similarly, the "should cost" studies Merck mentions (Merck Br. 35) have no relevance to GAO's right of access in this case.[25] Such studies entail "comprehensive reviews of contractors' operations" (J.A. 160a) in order to "evaluate the efficiency and economy of the contractors' operations" (*id.* at 161a) and to determine how much the contractors' products "should cost" the government (*ibid.*). Thus, the focus is on the efficiency of the contractor's business, not on the reasonableness of the relationship between the contractor's costs and the contract price. "Should cost" studies, unlike the access provisions, are not confined to negotiated contracts, are "not * * * limited to documents and records pertinent to particular contracts" (*id.* at 160a), and are not restricted to cost and pricing records but extend "broadly * * * to all documents, records, personnel, and other data" (*id.* at

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[24] The examples Merck cites principally involved "[c]ommercial sales records" (J.A. 163a) and "commercial records with respect to production scheduling and shipments" that "only incidentally, if at all, * * * [pertain to] cost and pricing data for the negotiated contracts * * *" (*id.* at 164a).

[25] The record in this case shows that the government has expressly disclaimed an intention to conduct a "should cost" review of Merck pursuant to the records access provisions. J.A. 125a.

161a) and "all aspects of operations and management, including but not limited to * * * production systems and controls[,] * * * plant design[,] * * * labor standards[,] * * * quality control systems[,] * * * equipment utilization[,] * * * [and] purchasing and subcontracting procedures * * *" (*id.* at 160a). GAO's recognition that its authority under the access-to-records provisions was insufficient to conduct "should cost" studies in no way undermines its request in this case for access to Merck's cost records necessary to assess the reasonableness of the price the government paid or the adequacy of procedures the contracting agency used.

III. THE COMPTROLLER GENERAL'S REQUEST FOR COST RECORDS WILL NOT LEAD TO UNLIMITED INTRUSIONS INTO THE PRIVATE SECTOR NOR WILL IT AFFECT MERCK'S METHOD OF ACCOUNTING OR ITS PROCEDURES FOR SETTING PRICES

A. Contrary to Merck's assumption (Merck Br. 16), the government's interpretation of the records access statutes will not lead to "examination of cost records that are completely unrelated to the contract on which the access demand is premised * * *." The government has never sought from Merck records relating exclusively to costs of goods other than those specified in the government's contracts, nor has it sought to examine records of costs recovered exclusively from non-governmental sources.[26] See, *e.g.*, Pet. App. 30a-31a; see also *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 918; *SmithKline Corp* v. *Staats*, *supra*, 668 F.2d at 210.

This claim is a variation on Merck's attempt to define the statutory language and construe the legislative history

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[26] Merck argues that the government may seek records dating back 20 years (Merck Br. 17). When read in context it is clear that the government's position is simply that before it has access to any records it cannot specify the period of documents covered by the request; that will turn on "the nature of [Merck's] pricing activities" and "the pertinency of individual cost and pricing records to transactions relating to [the] contracts." J.A. 51a. See C.A. App. 343.

within the confines of its own accounting procedures. The government's position remains, as it has throughout this litigation, that where Merck can show, through generally accepted accounting principles, that certain costs are related exclusively to other products—or are de minimis with respect to the contracts at issue—it has no obligation to produce the underlying records of those costs. Merck contends, however, that no such showing can be made because its internal accounting procedures commingle costs, failing to allocate costs or revenues to specific non-government items. This contention should be rejected; it is simply another effort by Merck to establish the primacy of its internal and wholly self-imposed accounting practices over the statutory and contractual access provisions.

In our view, Judge Mikva's opinion sets forth a sound resolution of this issue (Pet. App. 31a):

> the burden of showing that such costs are irrelevant must fall on Merck because only Merck has all the data necessary to make such a showing. Indeed, Merck acknowledges that it has already undertaken a number of cost studies of these unallocated costs, an undertaking that seems somewhat surprising if these studies are as inaccurate and meaningless as Merck claims.

GAO has obtained none of these records and is, accordingly, in no position to determine whether certain costs and revenues relate exclusively to non-contract items and are therefore outside the ambit of the request for records. In these circumstances, the only proper course is to place squarely on Merck the obligation to establish the irrelevance of records it chooses not to produce. In this way GAO's statutory investigative powers will not be eviscerated by the untested, undocumented assertions of a government contractor.

B. The Comptroller General issued the records request in this case in order to conduct a study of the reasonableness of prices and the adequacy of government procurement methods. A decision authorizing access to the docu-

ments necessary for the satisfactory completion of that study will not affect Merck's system of accounting or its procedures for setting prices.

Merck has chosen not to allocate the vast majority of its costs; there is no reason why that system cannot remain unchanged. Because GAO is empowered to review cost records in order to make recommendations about *government* procedures, it is not a necessary or even probable corollary that Merck need alter *its* procedures in any way. Thus, any allocations or calculations GAO may make—in consultation with the company—for the limited purpose of a procurement study need not affect the corporate accounting system any more than the "off books" allocations Merck already makes for top management (see Gov't Br. 38; Pet. App. 31a & n.33). In both instances the accountants may proceed with their work as before.[27]

Presumably Merck's concern is that if the government obtains cost data, its purchasing officers will be in a better bargaining position in future negotiations to seek price reductions or concessions. While in Merck's view this may suggest a certain equitable appeal in favor of nondisclosure, it provides no basis for the decision in this case. Our opening brief (Gov't Br. 18-19) discusses Congress' determination that an imbalance exists in the negotiation of government procurement contracts, with the scales heavily tipped to the private contractor's advantage. It was precisely in order to restore a greater equilibrium that the access provisions were enacted. See Pet. App. 11a, 21a-22a (Mikva, J., concurring in part and dissenting in part). The wisdom of this congressional decision is not an issue for judicial determination (see Gov't Br. 24-25) and is irrelevant to the resolution of this case.

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[27] Merck also contends that its prices are set without regard to costs. If this is the manner in which Merck chooses to set its prices, that system will be untouched by the Comptroller General's study. As we have explained (pages 6-8, *supra*), the focus of GAO's inquiry is on the buyer's—not the seller's—side of the transaction.

In the final analysis, other than obtaining documents, the Comptroller General cannot compel Merck to do anything further with regard to these contracts. The final authority resides, as always, with Merck. As a seller in a free market it retains the option not to sell to the government—the same option it had when it voluntarily entered into contracts containing access-to-records provisions.

IV. THE COMPTROLLER GENERAL'S REQUEST FOR RECORDS WAS MADE FOR A PROPER PURPOSE

Merck's final attempt to block access to its records presents a threadbare contention that has been rejected by every court to consider the issue. Specifically, Merck claims (Merck Br. 45-50) that the records were sought for the purpose of conducting an industry-wide economic study in order to placate certain Senators who had requested data on the pharmaceutical industry. Because, according to Merck, GAO's access demand was for "a clearly improper purpose," judicial enforcement of the demand should be denied. This claim has no legal or factual support.

In ruling on cross-motions for summary judgment, the district court found that "the survey proposed by the Comptroller in this case * * * will facilitate supervision of the procurement process and is within his authority." Pet. App. 38a.[28] This determination, which was affirmed by the court of appeals, is amply supported by the record.

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[28] Similarly, every court to consider the purpose underlying the Comptroller General's requests to the pharmaceutical companies has agreed that the requests were motivated, at least in part, by the desire "to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government's interests." *SmithKline Corp.* v. *Staats*, 483 F. Supp. 712, 721 (E.D. Pa. 1980). The court of appeals in *SmithKline* concluded that even if one were to assume the accuracy of the same factual allegations Merck makes here, "GAO did not invoke the access-to-records provisions for an improper purpose." 668 F.2d at 208. See *United States* v. *Abbott Laboratories*, 597 F.2d 672, 674 (7th Cir. 1979); *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 910.

J.A. 178a-179a; see J.A. 45a-46a, 116a-117a. See also *Rogers* v. *Lodge*, No. 80-2100 (July 1, 1982), slip op. 10. Because Congress plainly invested the Comptroller General with authority to review the reasonableness of prices charged the government and the adequacy of government procurement methods, there can be no doubt that the district court's conclusion is correct.[29] And, since the Comptroller General's request was predicated on a proper purpose, it is immaterial whether, as Merck alleges, he was motivated by any additional purposes that, *arguendo*, would not be sufficient by themselves to sustain the validity of the request. See, *e.g.*, *United States* v. *LaSalle National Bank*, 437 U.S. 298, 313-317 (1978); *Mt. Healthy City Board of Education* v. *Doyle*, 429 U.S. 274, 285-287 (1977).[30]

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[29] In light of the district court's finding that the records request was made for a purpose authorized by statute, "the issue as to the Comptroller's actual purpose" is, as the Third Circuit held in *SmithKline*, "not material" to the disposition of the case. 668 F.2d at 208. See Pet. App. 7a-8a & nn.7, 8 (Mikva, J., concurring in part and dissenting in part). We note, however, that the only appellate court to reach the question whether an industry-wide information study is an authorized purpose for GAO inquiry concluded that it is. *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 910-912.

[30] We also doubt that Merck should be heard to question any alleged additional purposes for GAO's request. Merck has never disputed the fact that it voluntarily entered into contracts containing access-to-records provisions, and the Comptroller General has now invoked those provisions to seek access to records for a purpose authorized by Congress. No rule of law excuses a party from performing obligations under a contract because it does not approve of the other party's purpose in demanding performance, and Merck should not be allowed to inquire further into the Comptroller General's motives.

Moreover, we disagree with Merck's repeated characterizations that these alleged additional purposes were "improper" or that the clearly proper purpose the district court found was a "sham." Even if Merck were correct in arguing that the statutes do not authorize a GAO research study, it would not follow that access to the records should be barred. Merck confuses an "improper" motive with a supplemental motive that is perfectly legitimate but not a sufficient ground, in the absence of a "proper" motive such as the court below

Although it is irrelevant to the issues before this Court, we will address briefly Merck's contention that events antedating the access-to-records demand in this case somehow negate the lawfulness of the Comptroller General's request. Merck claims that two Senators and members of their staffs suggested to the Comptroller General the desirability of a broad economic study of the pharmaceutical industry, that this congressional participation was improper, and finally, that this alleged impropriety taints the present, narrower review GAO proposes to undertake by means of its access authority.

First, we disagree with the suggestion, made without any legal support, that the identity of the person who initially alerts a federal agency to a possible subject of inquiry is in any way relevant, or that it may diminish the agency's discretion to investigate.[31] It is of no consequence whether the proposal comes from a private citizen, an agency employee, or a member of Congress. See *SmithKline Corp.* v. *Staats*, *supra*, 668 F.2d at 207 ("That United States senators encourage and influence GAO to use its powers to the fullest extent allowed by law, and that GAO heeds those senators, is irrelevant"); cf. *Gravel* v. *United States*, 408 U.S. 606, 625 (1972). The proposition that contact with Congress—the very forum to which GAO must report (see, *e.g.*, 31 U.S.C. 53(a), 60, 1154; Gov't Br. 14 n.10)—may tarnish agency proceedings is fanciful.

In addition, Merck is incorrect in contending that the study to be conducted pursuant to the records access provisions is the same "broad-based economic study" (Merck

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found, for access. There has been no suggestion that a study of individual contracts, focusing on the reasonableness of prices and adequacy of procurement methods, is forbidden by law or "improper" in any way. And no principle of law forbids the Comptroller General from using information lawfully obtained pursuant to his access-to-records power as part of a more general study.

[31] The record reveals that "[a]ll of the judgments that have been reached by the [GAO] on this matter have been independent judgments by the [GAO]." J.A. 79a; see *id.* at 179a.

Br. 46) initially contemplated at the Senators' behest. That study assumed voluntary cooperation by the companies and involved inquiries far more extensive than the access-to-records provisions authorize.[32] When it became clear that such cooperation would not be forthcoming,[33] the earlier proposals were significantly scaled-down to conform to the Comptroller General's access-to-records authority. Indeed, the very document Merck cites in support of its claim that GAO continued to anticipate a report "similar" to the earlier proposal (Merck Br. 48) demonstrates precisely the opposite. The language immediately preceding the words quoted by Merck states (J.A. 154a; emphasis added) that "if we were to use our right of access under specified Federal contracts, we would attempt, *insofar as possible*" to submit a "similar" report. Moreover, immediately following Merck's selective quotation, the memorandum continues (*id.* at 155a):

> He [a GAO officer] recognized that some changes would, of necessity, have to be made in that approach—particularly those changes related to (1) the time periods for which records could be obtained

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[32] Thus, for example, it need not have been limited to government contractors, to individual procurement contracts, or to the time period specified in the access provisions.

[33] Merck asserts (Merck Br. 47) that the sole reason the voluntary study failed was GAO's refusal, "at the behest of the two Senators," to guarantee confidentiality. The true explanation is not so simplistic. As the record indicates, the parties reached an impasse because the Comptroller General did not feel free to accede to an "ironclad or gold-plated or 100 percent guaranteee" (C.A. App. 312) against disclosure that could have "compromise[d] * * * rights that the Congress might have to place demands on [GAO] for information * * *." *Id.* at 316. At the time, GAO had no assurances that the companies would have participated fully in the study "even if we had been able to offer the ironclad guarantee" of confidentiality (*id.* at 313). In any event, Merck's argument is curious indeed, since GAO subsequently consented to a confidentiality provision and one is included in the district court's order (Pet. App. 42a-44a). Merck nonetheless steadfastly refuses to produce the documents requested by the Comptroller General.

and (2) the firms' products which could be included in the study.

Accordingly, when read in context, it is clear that GAO recognized the limits Congress placed on its powers and revised its earlier proposal to the more modest effort currently envisioned (C.A. App. 311). But those limits, expressly prescribed in the statutes, are the *only* ones Congress intended. Contrary to the pervasive theme of Merck's submission, Congress sought to provide the Comptroller General with the tools necessary to conduct meaningful studies of procurement practices by the federal government.

CONCLUSION

For the foregoing reasons, as well as those set forth in our opening brief, the judgment of the court of appeals should be reversed on the question presented in No. 81-1273 and affirmed on the questions presented in No. 81-1472.

Respectfully submitted.

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IN THE

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MERCK & CO, INC.

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CHARLES A. BOWSHER,
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AND UNITED STATES OF AMERICA

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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AFFILIATED COMPANIES

As required by Rule 28.1, Merck & Co., Inc.'s non-wholly-owned subsidiaries were set forth on page ii of Merck's opening brief in these consolidated cases.

Changes to that list are as follows: Banjo Polymers, Inc., should be deleted, and Astra/Merck, Inc., and Merck Sharp & Dohme Industrial E Exportadora Ltda., should be added.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

No. 81-1273

CHARLES A. BOWSHER,
COMPTROLLER GENERAL OF THE UNITED STATES,
AND UNITED STATES OF AMERICA,
Petitioners,

v.

MERCK & CO., INC.

No. 81-1472

MERCK & CO., INC.,
Petitioner,

v.

CHARLES A. BOWSHER,
COMPTROLLER GENERAL OF THE UNITED STATES,
AND UNITED STATES OF AMERICA

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF FOR MERCK & CO., INC.

Merck & Co., Inc. ("Merck") submits this reply brief as the petitioner in No. 81-1472.

INTRODUCTION

The government skillfully endeavors to create the impression that this case involves a government contractor's refusal to comply with a routine GAO request for access to its records. Consistent with this theme, the government accuses Merck of defaulting on a contractual undertaking to open its books to the Comptroller General and speculates that this recalcitrant behavior "[p]resumably" reflects Merck's concern that a review of its cost records will enable the government to negotiate lower prices in future contracts. (Gov. Opp. 23 & 25 n.30).[1] The government rounds out its characterization of the case with dire predictions that acceptance of Merck's position would render GAO's access-to-records authority "largely meaningless in a great percentage of government procurement cases." (Gov. Opp. 13).

The record, however, reveals a markedly different situation. Rather than shirking its contractual responsibilities, Merck along with five other major drug companies volunteered in 1973 to assist GAO by participating in the first phase of a GAO study of the economics of the pharmaceutical industry. (J.A. 30a-31a). When pressure from two Senators prevented GAO from providing assurances that the confidentiality of the companies' sensitive cost data would be protected, Merck and the other companies declined to take part in the second phase of the GAO study. (J.A. 110a-113a, 149a-151a). The Comptroller General, at the behest of the two Senators who desired to secure individual drug product cost data, then

[1] References in the form "Gov. Opp." are to the "Brief for the Respondents in No. 81-1472 and Reply Brief for the Petitioners in No. 81-1273." References in the form "Gov. Br." are to the "Brief for the Petitioners in No. 81-1273."

issued an unprecedented access-to-records demand designed to compel these companies to disclose virtually all of their cost records.[2]

Merck commenced this litigation because the extraordinary access demand issued by the Comptroller General threatens the confidentiality of sensitive financial records that it carefully guards from disclosure to its competitors.[3] The demand also poses a risk of significant disruption of Merck's operations.[4] As demonstrated below, the government's arguments in support of its sweeping demand issued to Merck give no effect to the express limitations

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[2] The government describes its access demand as part of a "modest proposal" to study the drug industry. (Gov. Opp. 4). Since the record establishes that GAO is claiming the right to examine the records of virtually all of Merck's costs incurred over a period that may reach back as far as twenty years (J.A. 50a-51a, 124a), it is evident that GAO's proposal is "modest" only in the Swiftian sense.

[3] The government appears to question the sincerity of Merck's concern over confidentiality because Merck did not volunteer to disclose its records to the Comptroller General after the district court included a confidentiality provision in its final order. (Gov. Opp. 27 n.33). The government, however, ignores the fact that these confidentiality protections were only obtained *after* Merck commenced this action to secure a judicial determination regarding the propriety of GAO's access demand. Moreover, contrary to the assertion in its brief, the government opposed the confidentiality provision entered by the district court. *See* Opposition of Defendant and Intervenor-Defendant to Plaintiff's Motion to Alter or Amend the Judgment, filed September 15, 1977. (R. 58).

[4] The record contains some information about the experience of the one company that voluntarily agreed to GAO review of its records in response to GAO's August 1974 access demand. This concrete experience underscores the substantial expense and disruption of operations that would be produced in complying with the GAO demand. At the time of the October 1976 Ahart deposition, a GAO team had been on site at Hoffman LaRoche, Inc. since July 1975 and had yet to complete its examination of the company's records. (J.A. 127a). Thus, GAO was like the "man who came to dinner," and Hoffman LaRoche finally terminated GAO's review of its records in July 1977.

placed by Congress on the scope of GAO's authority and ignore the effect of the unauthorized purpose that prompted it.

ARGUMENT

I. MERCK'S COST RECORDS ARE NOT DIRECTLY PERTINENT TO THE NON-COST-BASED, FIXED-PRICE CONTRACTS INVOLVED IN THIS CASE.

The critical determinant of the scope of GAO's access-to-records authority is the language employed by Congress. *See, e.g., Bread Political Action Committee v. FEC*, 455 U.S. 577, ___, 50 U.S.L.W. 4291, 4292 (No. 80-1481, decided March 8, 1982). Here, Congress carefully circumscribed its grant of authority by limiting the Comptroller General to those records of the contractor that "directly pertain to, and involve transactions relating to" individual procurement contracts. *See* 10 U.S.C. § 2313(b) & 41 U.S.C. § 254(c). The fundamental failing of the government's position is that each of the various interpretations it has advanced disregards the language employed by Congress in delineating the scope of the Comptroller General's access authority.

A. The Government's Interpretation Ignores The Express Limiting Language Employed By Congress.

From the outset of this litigation, the government has pressed for an interpretation of the access-to-records statute that would give GAO free reign to examine virtually all of Merck's cost records. In its opening brief, the government argued that GAO had the right to examine all "costs defrayed from commingled general revenues

that include the government's payments under the contract." (Gov. Br. 14). The government, however, made no attempt to explain how this standard relates to the statutory language requiring that the records requested "directly pertain to and involve transactions relating to" a specific procurement contract. The mere fact that Merck, like many companies, places revenues derived from government contracts and all other sources into a general corporate account does not provide a basis for exposing all of Merck's corporate expenditures to GAO scrutiny.[5]

Not surprisingly, the government makes no mention of its "commingling" standard in its most recent brief. Instead, while continuing to ignore the language of the statute, the government substitutes yet another standard of its own making for the one enacted by Congress. (Gov. Opp. 21-22). The government now claims a right to examine all of Merck's cost records except those records that Merck establishes "are related exclusively to other products." (Gov. Opp. 22). This latest standard also must be rejected, because it would replace the limited access granted by the statutory language with a virtually unlimited license to examine the private cost records of government contractors.

The extraordinary sweep of the access authority claimed by GAO is revealed by the record in this case.

[5] It is ironic that the government, which repeatedly (and incorrectly) accuses Merck of claiming that "the statutory term 'directly pertinent' must be defined by Merck's method of accounting" (Gov. Opp. 15), contends that the scope of GAO's access turns on whether the revenues received by Merck from a particular government contract are segregated in a separate account or are commingled with Merck's other revenues and operating funds in a general corporate account.

GAO asserts a right to examine *all* records of Merck's indirect costs for an unspecified number of years because those costs do not relate exclusively to any particular product. (J.A. 50a-51a, 124a). In practical terms, GAO is claiming the right to examine records of hundreds of millions of dollars of Merck's research and development expenditures and other indirect costs based on the access-to-records provision that is incorporated in every negotiated procurement contract involving a mere $10,000 purchase.[6] In addition, a senior GAO official has acknowledged that GAO is asserting a right to examine records of Merck's total cost of doing business on the theory that its overall company costs may somehow affect the prices charged to the government in the four procurement contracts listed in the GAO demand letter. *See* Appendix A, *infra*.[7]

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[6] At the time the four Merck contracts involved in this case were entered into, the standard form access-to-records clause was required by regulation to be incorporated in all contracts exceeding $2,500. The minimum dollar amount in effect at the present time is $10,000. *See* 41 C.F.R. § 1-16.901-32 (1981).

[7] The government attempts to make its demand appear less inflated by stating that Merck is not required to make available records of costs that it can show "are de minimis with respect to the contracts at issue." (Gov. Opp. 22). Under any sensible application of this aspect of the government's proposed standard—which, in any event, is far broader than the test enacted by Congress—GAO would have no right to examine any records of Merck's indirect costs. For example, only a miniscule fraction of Merck's total research and development expenditures are even theoretically reflected in the price charged the government in the four contracts involved in this case. Those four contracts involved sales totaling $2.8 million, or less than ¼ of 1% of Merck's 1974 sales of $1.330 billion. *See* Roy Aff., Exhibit H at 1 (1974 Annual Report of Merck & Co., Inc.) (R. 19, Ex. H).

However, because the government is claiming that GAO is entitled to examine records of all of Merck's indirect costs, it is evident

(footnote continues)

In its zeal to transform the limited access-to-records authority enacted by Congress into a tool for collecting massive quantities of private corporate cost data, GAO has advanced interpretations of the statute that fail to give effect to the express words of limitation adopted by Congress. It is thus hardly surprising that each of the last three courts of appeals to address the issue has held that GAO's grandiose demands for access to drug company cost records exceeded the scope of the access authority granted by Congress. *See,* in addition to the decision below, *SmithKline Corp. v. Staats,* 668 F.2d 201 (3d Cir. 1981), *petitions for cert. pending,* No. 81-2082 (filed May 10, 1982) & No. 81-2268 (filed June 9, 1982); *Bristol Laboratories Division of Bristol-Myers Co. v. Staats,* 620 F.2d 17 (2d Cir. 1980), *aff'd by an equally divided court,* 451 U.S. 400 (1981).

B. Merck's Interpretation Conforms To The Language Of The Access-To-Records Statute.

In contrast to the government's attempt to rewrite the statute, Merck's construction properly gives full effect to "every clause and word" of the access-to-records statute. *United States v. Menasche,* 348 U.S. 528, 538-39 (1955). As Merck explained in its opening brief, the extent to which cost records are "directly pertinent to and involve transactions relating to" a procurement contract depends on the type of contract at issue. (Merck Br. 27, 39-45).

(footnote continued)

that the government would not even follow its own de minimis test. The government appears to claim the right to examine *all* indirect cost records whenever a company's indirect costs are more than a de minimis proportion of its total costs. For most companies, this standard would provide no meaningful check on GAO's power to demand access to their private financial records.

There are three basic types of negotiated government procurement contracts—(i) cost-reimbursement contracts in which the actual price paid by the government varies with the contractor's cost of performance; (ii) cost-based, fixed-price contracts in which the price is negotiated on the basis of cost estimates supplied by the contractor but does not vary with the contractor's actual performance costs; and (iii) non-cost-based, fixed-price contracts in which a firm contract price is established without regard to the contractor's costs. Merck acknowledges, as it has throughout this litigation, that certain cost records are directly pertinent to the first two types of procurement contracts, because in those contracts the contractor's costs are involved in either the negotiation of the fixed contract price or the computation of the actual price paid by the government.

This case, however, does not involve either of the first two types of procurement contracts. Instead, as the government concedes, each of the four Merck contracts listed in the GAO demand letter was a non-cost-based, fixed-price contract. (J.A. 44a; Merck Br. 5-7.) Thus, unlike most negotiated government contracts, the prices in the contracts involved in this case were established on the basis of the published catalog prices at which Merck sold these standard pharmaceutical products in the commercial market or on the basis of other evidence of adequate price competition. None of Merck's cost records, therefore, are directly pertinent to or involve transactions relating to these contracts, because Merck's costs were irrelevant to the negotiation and pricing of the contracts.[8]

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[8] Merck's position that cost records are not directly pertinent to non-cost-based contracts is supported by related procurement statutes that expressly exempt the type of contracts involved here from

(footnote continues)

The government never addresses the basic issue—whether cost records are directly pertinent to and involve transactions relating to non-cost-based, fixed-price contracts. Instead, the government chooses to attack arguments that Merck has never made. For example, the government repeatedly asserts that Merck is claiming that all "fixed-price contracts are exempt from the access-to-records provisions" and attacks Merck for attempting to engraft exceptions onto the access provision that have no basis in the statutory language. (Gov. Opp. 2, 5, 8-10).

Merck, however, has never claimed that fixed-price contracts, or any other types of negotiated procurement contracts, are exempt from the access-to-records statute. Rather, Merck contends that, under the statutory language adopted by Congress, the Comptroller General is not empowered to demand access to *cost* records when the contract at issue was not negotiated on the basis of the contractor's costs and when the price charged the government does not depend on the contractor's cost of performance.[9]

(footnote continued)

provisions providing for review of cost data. (Merck Br. 42-45). The government asserts that these statutes actually support its position because the access-to-records statute does not contain any express exemptions. (Gov. Opp. 9 n.12). Here, too, the government misses the point. The related procurement statutes provide important guidance in applying the "directly pertinent" standard of the access-to-records statute, because Congress would not have exempted the type of contracts involved in this case from a variety of cost review requirements if it considered cost records "directly pertinent" to this type of contract.

[9] From the outset of this case, Merck has agreed that certain of its non-cost records are directly pertinent to the four contracts that were the subject of the Comptroller General's access-to-records demand. (J.A. 33a; Merck Br. 27). Thus, Merck has offered to make available

(footnote continues)

Similarly, the government persists in its unfounded assertion that Merck's statutory interpretation argument is premised on its accounting system. *Compare* Gov. Opp. 3, 15-16, 22-23 *with* Merck Br. 18-20.[10] Contrary to the government's assertions, Merck does not contend that its unallocated costs are "by definition not directly pertinent to the government's contracts." (Gov. Opp. 3). For example, Merck has consistently acknowledged that regardless of whether costs are allocated to specific products by a company's accounting system, records of the contractor's cost of performance would be directly pertinent to a *cost-reimbursement* contract. By contrast, although Merck's accounting system does allocate certain direct manufacturing costs to individual products, Merck contends that *none* of its cost records are directly pertinent to the particular type of procurement contract involved in this case.[11]

(footnote continued)

all records necessary to audit these individual contracts, including records required to verify that Merck actually had an established catalog price for the products purchased and that the items were sold in substantial quantities to the general public at the catalog price.

[10] Under Merck's accounting system, no costs are allocated to individual contracts and only three cost elements (direct materials, direct labor, and certain production unit overhead items) are allocated on an individual product basis. (J.A. 34a). As the government has conceded (Gov. Br. 34), there are no generally accepted accounting principles governing the allocation of indirect costs such as administration and research and development expenses. The limited extent to which Merck allocates costs to individual products is similar to the approach taken by other major pharmaceutical companies. (J.A. 132a-133a).

[11] The government places great emphasis on the fact that Merck has occasionally made broad allocations of certain indirect costs for internal planning purposes. (Gov. Opp. 16 & n.18; J.A. 54a-55a, 57a,

(footnote continues)

Nor did the district court or the court of appeals ascribe any significance to the manner in which Merck allocates costs within its accounting system. The courts below did not even refer to Merck's allocation of its costs in their opinions, but instead focused, as Merck has, on whether records of Merck's costs are directly pertinent to and involve transactions relating to the non-cost-based, fixed-price contracts involved in this case. (Pet. App. 2a-3a, 35a-40a). The courts below, like the Second Circuit and the Third Circuit, have decided that *some* costs do fit this standard. But they have taken a functional approach, distinguishing between certain direct costs and general, indirect costs, regardless of the extent to which Merck or any other contractor allocates these costs internally. The government's allocation argument is thus a particularly puzzling "straw man," since neither Merck nor any of the many courts which have ruled against GAO's position has ever said that the application of the access statute turns on an individual company's internal accounting.

II. GAO CANNOT RELY ON ITS GENERAL INVESTIGATORY RESPONSIBILITIES TO JUSTIFY ITS SWEEPING ACCESS DEMAND.

The government seeks to persuade this Court that the critical words of limitation employed by Congress should be disregarded because they would impede GAO's ability

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61a). The record makes clear, however, that these broad allocations are based on an arbitrary ratio, generally the product's percentage of Merck's total sales. (J.A. 54a-55a, 57a, 61a). These occasional, mechanical allocations do not involve a review of Merck's individual cost records in an attempt to reconstruct the actual, total cost of developing and producing a particular product. They thus bear no similarity to the detailed review of Merck's costs that GAO proposes to make through its access-to-records demand.

to fulfill its "oversight responsibilities for the entire procurement process." (Gov. Opp. 7). The government summarizes this argument as follows (Gov. Opp. 18):

> Having charged GAO with investigating '*all* matters relating to the receipt, disbursement, and application of public funds' and 'mak[ing] recommendations looking to greater economy or efficiency in public expenditures' (31 U.S.C. § 53(a) (emphasis added); see 31 U.S.C. § 1154), it is inconceivable that Congress then provided access-to-records authority for studies of only 'limited utility.'

This argument is fundamentally flawed. Not only is it conceivable that Congress may have granted GAO only limited access to the records of private companies, it is indisputable that Congress considered it unnecessary to grant GAO *any* right to examine such records when it charged GAO with those broad investigatory and reporting responsibilities.

Congress assigned GAO its responsibilities to investigate and report on the disbursement of public funds in 1921 when it established the General Accounting Office. *See* 31 U.S.C. § 53(a). In order to enable GAO to discharge its responsibilities, Congress at that time empowered the Comptroller General to demand access to "*any* books, documents, papers, or records of *any*" government department or establishment. 31 U.S.C. § 54 (emphasis added). However, Congress did not grant GAO the right to examine the books and records of private companies doing business with the government until 30 years after it invested GAO with the responsibilities on which the government now places such heavy reliance. Thus, there is no historical connection between GAO's

1921 authority to examine the efficiency of public expenditures and the 1951 access-to-records statute at issue in this case.[12]

When Congress decided to grant GAO *some* authority to review private records, it surrounded this power with clear and deliberate limits. These limits reflect the congressional awareness of the need to balance legitimate competing interests. As explained in Merck's opening brief, the access authority originated in January 1951 as a floor amendment to temporary legislation enacted in response to the Korean War emergency and was not intended as a device for giving GAO authority to conduct

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[12] The government also errs in arguing that GAO's access-to-records authority must be interpreted expansively because the scope of GAO's access would otherwise be limited to the same records that the purchasing agencies are authorized to examine. This argument ignores the fact that, when GAO was granted its access-to-records authority in 1951, the contracting agencies had not yet been accorded such authority. There is thus no reason to believe that the access authority granted GAO in 1951 was intended to be broader than the authority subsequently given to the purchasing agencies.

In fact, the legislative history of the 1968 statute that granted the defense contracting agencies a right of access to contractor's records reveals that Congress intended to provide those agencies with "the same type of access to records that the Congress has now made available to the General Accounting Office." *Hearings on the Review of Defense Procurement Policies, Procedures and Practices Before the Subcommittee for Special Investigations of the House Armed Services Committee*, 90th Cong., 1st Sess. 61 (1967) (testimony of John M. Malloy, Deputy Secretary of Defense). As explained in detail in the *amicus* brief of the Aerospace Industries Association, those contracting agencies have exercised their access powers in a manner consistent with what Merck argues is the proper scope of GAO's powers.

broad-ranging studies designed to improve the performance of the procurement process. (Merck Br. 21-23).[13] Among the amendments added during Congress' consideration of the permanent access-to-records legislation to underscore the limited scope of the authority being granted was the amendment restricting the scope of the Comptroller General's access authority to records that "directly" pertain to a particular procurement contract. The stated purpose of the amendment was to safeguard contractors against "snooping" by GAO. *See* 97 Cong. Rec. 13377 (1951) (remarks of Rep. Hoffman).

Significantly, the government fails to cite a single statement in the legislative history in support of its claim that the access authority was intended to enable GAO to investigate the general adequacy of procurement techniques. Indeed, GAO's own contemporaneous assessment of the access-to-records legislation made no reference to the broad research purposes which GAO now claims Congress intended to promote in enacting the statute. (Merck Br. 32-33.) The absence of any reference to such a r .pose in the legislative history strongly suggests that the statute was "not _ means by which government agencies can improve their procurement techniques for use in future contracts." Note, *Government Contracts: Contractor's Obligation to Allow Examination of Records*

[13] The government's rejoinder that GAO's access authority was later made permanent (Gov. Opp. 8 n.8) contains an inaccurate implication that the permanent legislation expanded the scope of the access provision. Statements of the permanent statute's sponsor, the relevant House and Senate committee reports, and GAO's own contemporaneous understanding all make clear that the permanent legislation was intended "merely" to "carr[y] into our general procurement statutes the same principle" embodied in the emergency amendments to the First War Powers Act. 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy); *see* Merck Br. 24.

Under 10 U.S.C. 2313(b). 72 Dick. L. Rev. 687, 691 (1968).

III. ADOPTION OF MERCK'S INTERPRETATION OF THE ACCESS-TO-RECORDS STATUTE WILL NOT INTERFERE WITH GAO'S ABILITY TO DISCHARGE ITS RESPONSIBILITIES.

Unable to find support for the scope of its demand in either the language of the statute or its legislative history, the government resorts to the *in terrorem* assertion that the interpretation advanced by Merck would "effectively negate" GAO's ability to fulfill its statutory duties and render "the access provisions largely meaningless in a great percentage of government procurement cases." (Gov. Opp. 13). The record, however, belies this ominous prediction. It establishes that adoption of Merck's interpretation of the access-to-records statute would not have had any significant impact on GAO's access authority as actually used over the past 30 years.[14]

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[14] GAO can point to only one prior instance during the past 30 years in which it demanded access to a contractor's cost records in connection with the type of non-cost-based, fixed-price contract involved in this case. That instance involved a demand issued to the Hewlett-Packard Company in the 1960s and also resulted in litigation.

As Merck noted in its opening brief, the Ninth Circuit decision permitting GAO to examine Hewlett-Packard's costs is based on a patently erroneous reading of the statutory language, which the government has never advanced in the litigation growing out of the 1974 demands. (Merck Br. 41-42). *See Eli Lilly & Co. v. Staats*, 574 F.2d 904, 918-19 (7th Cir.), *cert. denied*, 439 U.S. 959 (1978) (Pell, J., dissenting); Note, *Eli Lilly & Co. v. Staats: An Undue Expansion of the GAO's Investigatory Power Under the Access-to-Records Statutes*, 74 Nw. U.L. Rev. 122, 130-31 (1979). Moreover, in *Hewlett-Packard*, GAO only received access to records of the *direct* costs of producing the specific items supplied under the procurement contracts. *Hewlett-Packard Co. v. United States*, 385 F.2d 1013, 1016 (9th Cir. 1967), *cert. denied*, 390 U.S. 988 (1968).

GAO's use of its access-to-records authority has been devoted almost exclusively to conducting audits of *cost-based* contracts. (Merck Br. 37-38). GAO also has audited some non-cost-based, fixed-price contracts to determine whether items purchased through contracts negotiated on the basis of the contractor's catalog price were sold in substantial quantities to commercial purchasers and therefore qualified for the "catalog price" exemption from the requirement of submitting cost and pricing data. *See Hearings on the Review of Defense Procurement Policies, Procedures and Practices Before the Subcommittee for Special Investigations of the House Armed Services Committee,* 90th Cong., 1st Sess. 11, 40 (1967).[15] The interpretations of the statute advanced by Merck would permit access to all of the records necessary to evaluate the propriety of the contracting officer's reliance on the contractor's catalog price and thus would not impede GAO's audit of non-cost-based contracts.

Moreover, denial of GAO's demand for Merck's cost records will not interfere with GAO's ability to meet its statutory responsibilities, because GAO is not proposing to audit the four Merck contracts listed in the Comptroller General's demand letter. (J.A. 45a). Instead, the access demand was issued to Merck as a means of gathering data for an economic study of the pharmaceutical industry. The record establishes that GAO had never attempted to use its access-to-records authority for such a purpose during the more than 20 years preceding the issuance of

[15] An example of such an audit is the HY 80 steel plate report cited by the government (Gov. Opp. 19) in which GAO found that the Navy improperly awarded contracts on the basis of the suppliers' catalog prices, because the Navy purchased 98% of the contractors' total production of that specialized type of steel plate. Deposition of Gregory J. Ahart, Exhibit PA-61 at 10. (R. 43).

the 1974 demand to Merck and the other pharmaceutical companies. (J.A. 47a, 83a-104a, 175a-176a).[16]

Testimony by the Comptroller General who signed the demand letters makes it particularly difficult to credit the government's dire predictions concerning the effects of a denial of its access demand. Before bowing to pressure from two Senators who insisted that he invoke his access authority to obtain drug company cost data, Comptroller General Staats testified that such data would not serve any purpose useful to GAO, because "it would be impossible to develop from [the companies'] internal accounts what their costs are with respect to an individual drug." *Hearings on Competitive Problems in the Drug Industry Before the Subcommittee on Monopoly of the Senate Select Committee on Small Business,* 92d Cong., 2d Sess. 8573 (1972). He concluded that use of the access-to-records authority to examine individual contracts for the purchase of pharmaceutical products would be "a waste of time." *Id.* at 8578.

IV. GAO'S ACCESS DEMAND REPRESENTS A MISUSE OF THE ACCESS-TO-RECORDS STATUTE.

In addition to ignoring the limits Congress placed on the scope of GAO's access-to-records authority, the Comptroller General's demand for access to Merck's records is

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[16] In response to interrogatories served by Merck, GAO claimed that it had previously used its access-to-records authority to engage in five industry-wide studies. (J.A. 47a). However, as a senior GAO official has acknowledged (J.A. 83a-104a), these alleged "studies" were actually contract audits that were not comparable to the broad-based economic study proposed to be made with data gathered through the access demands served on Merck and the other pharmaceutical companies. *See* J.A. 175a-176a (discussing the "studies" relied upon by GAO).

defective because it was not made for a purpose authorized by Congress. In contrast with its prior use of its access-to-records authority to audit individual contracts, the demand in this case was made by GAO solely at the urging of two Senators. (Merck Br. 3-5, 46-47).

The government attempts to sidestep this issue by focusing on the district court's conclusion that the *result* of the survey would be "to facilitate supervision of the procurement process . . . . " (Gov. Opp. 24, *quoting* Pet. App. 38a). The issue raised by Merck, however, is the permissibility of GAO's *purpose* in issuing the demand. The only court that has ruled on that factual issue was the district court in *Eli Lilly,* which found that the GAO demand was unauthorized because "Congress has not given the Comptroller General coercive power to require private companies to participate in research projects undertaken by the GAO." *Eli Lilly & Co. v. Staats, supra,* 574 F.2d at 924 (Pell, J., dissenting) (reprinting district judge's decision).

Before this Court, the government acknowledges that the access demand was made "at the Senators' behest," but argues that "the identity of the person who initially alerts a federal agency to a possible subject of inquiry" is irrelevant. (Gov. Opp. 26-27). This response misses the point. Merck's argument rests on the impropriety of using the access provision as a device to compel disclosure of private corporate records for the benefit of public officials who otherwise have no right to the records, not on the identity of the persons urging such a misuse of the access statute. For example, although it may be appropriate for the SEC to investigate a company in response to evidence provided by a Senator about misstatements of earnings, it would be a serious abuse for the SEC to subpoena a

company's confidential financial records to satisfy a Senator's desire to obtain the information. The situation is comparable here.

The government also labors to demonstrate that the access demand was not issued to secure Merck's cost records for an economic study of the drug industry but to study the operation of the procurement system. (Gov. Opp. 26-28). Neither of those goals, however, would be within the purposes for which the access power was granted. Moreover, the government's response in effect concedes that the "procurement study" is a smokescreen and that the GAO's only arguable interest in pursuing access was to attempt to carry out the Phase II economic study proposed by GAO in the spring of 1974. (Gov. Opp. 27-28, discussing an internal GAO memorandum reprinted at J.A. 153a-156a). As the government acknowledges, GAO issued its access-to-records demand in order to conduct "insofar as possible" the same drug industry economic study that it had previously proposed to undertake with the cooperation of the pharmaceutical companies. (Gov. Opp. 27, *quoting* J.A. 154a.)

In order to sustain this unprecedented use of the access-to-records statute, the government must demonstrate "an affirmative grant of . . . authority . . . in the [statute] or its legislative history." *United States v. LaSalle National Bank,* 437 U.S. 298, 316 n.18 (1978). Here, the government has made no effort to establish that Congress authorized GAO to compel contractors to disclose data for use in its economic studies. Indeed, the statute's origin in temporary, emergency legislation and the deliberate limitations placed on GAO's access authority provide affirmative evidence that Congress did not intend the statute to be used for such a purpose.

CONCLUSION

The judgment of the court of appeals should be affirmed on the question presented in No. 81-1273 and reversed on the questions presented in No. 81-1472.

Respectfully submitted.

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November 1982.

Excerpts from the Deposition of Gregory J. Ahart, Director, Human Resources Division, General Accounting Office

1. *Page 135 (J.A. 117a)*

Q Would you look at costs which the manufacturers do not consider in setting prices?

A If they affect the prices paid by the Government, yes, we would.

Q Could you explain to me how they would affect the prices if they are not considered in the pricing decision?

A Well, as I indicated earlier at least as being represented to us, you almost have to look at the overall business to understand the considerations taken into account in the establishment of prices.

Overall, the companies, I'm sure, establish prices for their full range of products which they expect will result in a profit and, somehow or other, this requires that, in total, the sales dollar, in orders by the Government or other parties, must cover all of the costs of the going concern as well as to produce a profit.

So the prices paid by Government do contribute to, in some measure, the total costs of operating the business and furnishing a return on the capital.

2. *Page 144 (J.A. 122a-23a)*

Q Well, we are back to "directly pertinent," again. How direct does "directly pertinent" have to be in order to come within your claim of right? Can you give me some feel for that?

A Well, in answer to the Interrogatory that we are talking about here, one test is whether or not these affect the prices paid by the Government.

Q Even though the company may not have taken them into account in establishing a price?

A Even though the company may not have taken them specifically into account in establishing a price.

Q The fact that they are there as a general ambient of the company's business is enough to make them directly pertinent to the performance of the contract?

A In my judgment, that would be.

Q And this is true even if a company only has one Government contract?

A Since the access to records clause is brought to bear on an individual contract basis, yes.

3. *Page 152-53 (J.A. 124a-25a)*

Q But you are unable, today, to give me any idea what the limitations on the time periods would be, is that correct?

A Yes, that is correct. The constraints are as I stated but without more specific knowledge than we possess, we can't be more specific.

Q So even if costs were not considered in pricing a particular product, conceivably you would insist on the right to records that might be 20 years old or might relate to costs incurred 20 years ago?

A If they were determined to be directly pertinent to the contract.

Q But we have no way of deciding how they might be directly pertinent. There is no way you can define how you would make that test.

A If they affect the prices, if they are given consideration during the pricing of the—

Q No, they are not given consideration by the company in making its pricing decision.

A If they are not given specific consideration, we would have to make a judgment as to whether or not, irrespective of specific consideration, they affect the prices.

Q In the sense that you described before, that they relate to the company's overall costs and, sooner or later, the company wants to make a profit on a company-wide or division-wide basis?

A Yes.

Amicus Brief

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Nos. 81-1273, 81-1472

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On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF *AMICUS CURIAE* OF THE AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.

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---

BRIEF *AMICUS CURIAE* OF THE AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.

Pursuant to Rule 36 of the Rules of this Court and with the written consent of counsel for both parties,[1] the Aerospace Industries Association of America, Inc. ("AIA"), respectfully files this brief *amicus curiae* in support of respondent and cross petitioner, Merck & Co., Inc. ("Merck").

---

[1] Letters of consent have been filed with the Clerk.

INTEREST OF THE *AMICUS CURIAE*

AIA is the national trade association representing forty-nine United States companies which are engaged in the research, development and manufacture of such aerospace systems as aircraft, missiles, spacecraft, and space launch vehicles; propulsion, guidance, and control systems for flight vehicles; and a variety of airborne and ground-based equipment essential to the operation of the flight vehicles. The industry AIA represents is one of the nation's largest. Its sales in 1981 amounted to $63.5 billion, including $52.9 billion in sales of aerospace products and services and $10.6 billion in nonaerospace products.

The court of appeals in this case affirmed the holding of the district court that the Comptroller General had authority to examine certain cost records under clauses included in Merck's contracts pursuant to 10 U.S.C. § 2313(b) (1976) and 41 U.S.C. § 254(c) (1976). The district court had rejected Merck's contentions that cost records were not "directly pertinent" to the type of contracts involved, and that the Comptroller General's access demand was unlawful because it was for the purpose of studying industry profits rather than reviewing the particular contracts. The court of appeals also affirmed the district court's limitation on the Comptroller General's right of access to records of direct costs. This *amicus* brief does not address this latter holding of the court of appeals.

The decision is of major consequence to the aerospace industry. Pursuant to contract clauses required by sections 2313(b) and 254(c), the Comptroller General, acting through the General Accounting Office ("GAO"), regularly examines transactional records for negotiated contracts of AIA members.[2]

---

[2] The GAO employs over three thousand "evaluators" who comprise its auditing staff. *See* 1981 Gen. Acct. Off. Ann. Rep. 10.

AIA members furnish a broad range of supplies and services to the Department of Defense ("DOD"), the National Aeronautics and Space Administration ("NASA") and other government agencies, acting as both prime contractors and subcontractors. The types of contracts involved vary depending on the nature of the procurement. Most of the contracts include contract clauses granting access to records for both the Comptroller General and the contracting agencies.

In terms of dollar value, most of the negotiated contracts of AIA members are priced on the basis of costs. Many have fixed prices, for which proposals are solicited with prices based upon estimates of costs. Others, which vary greatly in form, provide for a price which is a function in whole or in part of costs incurred during performance and is not fixed firmly in advance.

The Merck contracts at issue here are another type of negotiated contract. Competitive proposals were solicited with fixed contract prices based on catalog prices.[3] The position advanced by the government would allow GAO to obtain access to cost records for purposes wholly unrelated to the particular contract and its pricing. It would give GAO access to cost records even though costs were not a factor in establishing the contract prices. This is contrary to established practices and potentially disruptive for all negotiated contracts.

AIA requests that the Court consider the issues here in the context of the overall community of negotiated contracts. Long-standing, sensible, and well-defined bounds exist for the government's access to records under all of the various types of negotiated contracts. Granting access to cost records here would exceed those bounds. Such access is neither needed to protect legitimate government interests nor warranted by the language of the statute or its legislative history.

---

[3] Some contracts of AIA members are of the same type.

SUMMARY OF ARGUMENT

I

Federal statutes governing procurement of supplies and services divide government contracts into two major groups: formally advertised and negotiated. Negotiated contracts included:

1. Contracts in which the price is dependent in whole or in part on costs *incurred* by the contractor during performance;
2. Contracts in which the price is fixed in advance on the basis of *projected* contractor costs; and
3. Contracts, such as those at issue in this case, with fixed prices for which the contractor's costs are *not* a factor in the pricing of the contract.

Under such negotiated contracts, access to directly pertinent contractor records is provided to the Comptroller General through contract clauses required by 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c) and to the Department of Defense and other agencies by the Truth in Negotiations Act, 10 U.S.C. § 2306(f) (1976 & Supp. IV 1980), and related regulations.

Sensible limits on the right of access to cost records have been established under the Truth in Negotiations Act, and related regulations:

1. If the contract price depends in whole or in part upon the incurred costs of performance, the government has access to the cost records involved.
2. If, instead, the contract price is fixed in advance and this is done on the basis of cost estimates, the government has access to cost records but solely for the purpose of verifying the cost estimates relied on in the original pricing of the contract.

3. If the contract is based on catalog or market prices rather than on the contractor's costs, the government normally does not have a right of access to cost records. Contractor records are directly pertinent only if and to the extent needed to verify that the contract price is based on "established catalog or market prices of commercial items sold in substantial quantity to the general public."

II

The Comptroller General's right of access to cost records does not and should not extend beyond that allowed the contracting agencies under the Truth in Negotiations Act. Sections 2313(b) and 254(c) place stringent limitations upon the GAO's right of access. The records must "directly pertain, and involve transactions relating to, the contract." The word "directly" was added for the express purpose of preventing government "snooping." By comparison, the language in 10 U.S.C. § 2306(f)(3) is less confining. It grants the Department of Defense and others a right to examine all records "related to the negotiation, pricing or performance of the contract."

There is a fundamental similarity of purpose behind the Truth in Negotiations Act and the statutes granting the GAO's access to records. In both, the congressional concern was for the pricing of negotiated contracts where price competition is inadequate. Therefore, transposing to the Comptroller General the well-established limits upon rights of examination provided under section 2306(f) is sound.

The position advanced by the government gives no effect to the words of limitation in sections 2313(b) and 254(c). In contrast, limiting the Comptroller General's access rights to the specific and long-established bounds on examination by the contracting agencies gives practical meaning to all the language in those sections. It

is a sensible, cost-effective application of those sections and their legislative history. It allows the Comptroller General access to cost records to the extent they directly pertain to the negotiation of the contract price. It gives effect to the reasonable expectations of contractors when they enter contracts priced on the basis of catalog or market prices. Merck did not interpret the clauses in its contracts to mean that the Comptroller General would have the broad examination rights he demands, nor would any reasonably prudent contractor.

III

The Comptroller General is required to use its access to records authority for the purpose intended by Congress. That authority does not extend to investigation of *industry* profit levels at the instigation of individual congressmen, the true purpose for GAO's demands upon Merck. The GAO, in relying on the access to records authority granted under sections 2313(b) and 254(c), cannot extend its investigation into records which do not directly pertain and involve transactions relating to the particular negotiated contract involved. Lacking a proper purpose, the Comptroller General's demand for contractor records in this case should not be enforced.

ARGUMENT

I. SENSIBLE AND CAREFULLY DELINEATED LIMITATIONS UPON THE GOVERNMENT'S RIGHT OF ACCESS TO RECORDS ARE IN PLACE

A. Congress Has Statutorily Defined The Methods Of Government Procurement And Established Safeguards On The Pricing Of Negotiated Contracts

The procurement of supplies and services by the Department of Defense, NASA, the Coast Guard and, to some extent, the Central Intelligence Agency is governed generally by the Armed Services Procurement Act of 1947 ("ASPA")[4] and implementing regulations, principally the Defense Acquisition Regulations ("DAR").[5] During fiscal year 1981, DOD and NASA were responsible for more than 81% of all government procurement.[6] Procurement by most civilian agencies is governed generally by sections 301-310 of the Federal Property and Administrative Services Act of 1949 ("FPASA")[7] and implementing regulations, principally the Federal Procurement Regulations ("FPR").[8]

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[4] 10 U.S.C. §§ 2301-2314 (1976 & Supp. IV 1980); 50 U.S.C. § 403c (1976). *See* 1 Report of the Commission on Government Procurement 15 (1972) ("COGP Report").

[5] 32 C.F.R. pts. 1-39 (1981). The Defense Acquisition Regulations ("DAR") were formerly known as the Armed Services Procurement Regulations ("ASPR"). The National Aeronautics and Space Administration has its own semiautonomous regulations, NASA Procurement Regulations ("NASA PR"), 41 C.F.R. ch. 18, pts. 1-52 (1981).

[6] During fiscal year 1981, government procurement totaled $134.4 billion. DOD and NASA accounted for $104.2 billion and $4.96 billion, respectively. Federal Procurement Data System, established by the Office of the Federal Procurement Policy Act Amendments of 1979, Pub. L. No. 96-83, 93 Stat. 648, 96th Cong., 1st Sess. (1979) (codified as amended at 41 U.S.C. §§ 401-412 (Supp. IV 1980)).

[7] 41 U.S.C. §§ 251-260 (1976).

[8] 41 C.F.R. subtitles A & B (1981). *See* 1 COGP Report at 33.

Those statutes [9] and regulations divide government procurement into two major types,[10] formally advertised and negotiated. The first, formally advertised, denotes a sealed-bid technique of obtaining fixed-price offers for identical products from several competitors. Bid prices are firm and not subject to negotiation.[11]

The second major grouping, negotiated procurements, includes essentially all procurements other than those awarded by formal advertising.[12] In terms of dollar value, most negotiated contracts are cost based. Some of these are let for fixed prices.[13] Others are priced on a cost-reimbursable, cost-sharing, or incentive basis.[14] The negotiated contracts at issue here fall into a distinctly different class. They were not cost based. They were priced based upon Merck's catalog prices.[15]

Congress has legislated safeguards upon the pricing of negotiated contracts, including statutes which provide for access to records. Sections 2313(b) and 254(c) require clauses giving a right of access to the GAO. The Truth in Negotiations Act, 10 U.S.C. § 2306(f),[16] gives access to DOD and NASA. These statutes differ significantly in form and language. Section 2313(b) requires contract clauses providing that

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[9] *See* 10 U.S.C. §§ 2304-2306 (1976 & Supp. IV 1980); 41 U.S.C. §§ 252-254 (1976).

[10] Under ASPA and FPASA, simplified procedures are authorized for procurements of less than $10,000. DAR 3-600-610; FPR 1-3.600-607. These might be viewed as a third distinct type of procurement. *See* 1 COGP Report at 26-27.

[11] *Id.* at 18.

[12] 10 U.S.C. § 2303(2) & (3); 41 U.S.C. § 252(c).

[13] *See, e.g.*, Firm Fixed-Price Contracts, DAR 3-404.2.

[14] *See, e.g.*, Cost-Reimbursement Type Contracts, DAR 3-405.

[15] *See* DAR 3-807.7(b)(2)a-d.

[16] With certain exceptions, the Truth in Negotiations Act requires, *inter alia*, that for negotiated contracts expected to exceed $100,000, the contractor must submit and certify cost and pricing data which is accurate, complete and current. *Id.*

> the Comptroller General and his representatives are entitled, until the expiration of three years after final payment, to examine any books, documents, papers, or records of the contractor, or any of his subcontractors, that directly pertain to, and involve transactions relating to, the contract or subcontract.

Section 254(c) is to the same effect.[17] 10 U.S.C. § 2306 (f) (3) grants to DOD and NASA under negotiated contracts a right

> to examine all books, records, documents, and other data of the contractor or subcontractor related to the negotiation, pricing, or performance of the contract or subcontract.

Comparable rights have been extended to civilian agencies.[18] Relevant procurement regulations specify contract clauses carrying out these statutory requirements.[19]

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[17] Section 254(c) requires a contract clause providing that the Comptroller General and his authorized representative

> shall . . . have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors engaged in the performance of and involving transactions related to such contracts or subcontracts.

As the government concedes, the difference in the language of §§ 2313(b) and 254(c) is without substantive effect. Brief for Petitioners in No. 81-1273 at 18 n.12 ("Brief").

[18] The Truth in Negotiations Act amended only the ASPA. However, the "basic concepts" of the Act have been extended to civilian procurement by regulation. *See* 1972 Comptroller Gen. Ann. Rep. 63. These regulations contain provisions similar to those of the Truth in Negotiations Act and the DAR, including provisions for access to records by the contracting agency, governing the negotiation and pricing of civilian contracts. *See id.*; FPR 1-3.807-1, 1-3.807-2, 1-3.807-3, 1-3.814.2.

[19] DAR 7-104.15 specifies an Examination of Records by Comptroller General clause for applicable DOD contracts. This clause tracks the language of § 2313(b). *See also* FPR 1-7.103-3; NASA PR 7.104-15. DAR 7-104.41 prescribes an Audit by Department of Defense clause. *See also* NASA PR 7.104-42; FPR 1-3.814-2.

DOD and NASA, acting under section 2306(f) and through the Defense Contract Audit Agency ("DCAA"), and the civilian agencies examine cost records relating to cost-based negotiated contracts on a regular basis. This, like the GAO's examinations, is a significant operation with the DCAA occupying office space at a contractor's plant and assigning a substantial number of auditors full time to examine contractor's records.[20]

B. There Are Well-Established Bounds Upon The Government's Right To Examine Which Vary With The Manner In Which The Contract Is Priced

In the course of implementation of the Truth in Negotiations Act, sensible bounds have been developed for the government's right to examine. These reflect a careful balance between the government's legitimate need to know and verify and the contractor's concern for the confidentiality of internal records, and for the burden of document examination.

As discussed below, GAO's right of access to cost records should not extend beyond these bounds. These established limits recognize that for negotiated procurements priced on the basis of competitive or market forces, examination of contractor cost records is not required.[21]

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[20] The DCAA effectively performs its contract audit function. *See* 1971 Comptroller Gen. Ann. Rep. 85; 1970 Comptroller Gen. Ann. Rep. 74. This refutes Judge Mikva's suggestion that an expansive interpretation of GAO's authority is necessary for "shedding light where *none* had been cast before." Merck & Co. v. Staats, 665 F.2d 1236, 1241 (D.C. Cir. 1981), Appendix to Petition in No. 81-1273 ("Pet. App.") at 11a (emphasis added).

[21] The Truth in Negotiations Act authorizes an exemption from the data submission and access to records requirements for contracts in which prices are "based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, [or] prices set by law or regulation." 10 U.S.C. § 2306(f)(1) & (2). *See* DAR 3-807.3(b) & (e), 3-807.6(d), 3-807.7(a), (b) & (c). *See also* NASA PR 3.807-3(b) & (e), 3.807-6(d), 3.807-7(a), (b) & (c); FPR 1-3.807-3(b) & (d)(1).

Where this is not the case, DOD and NASA, and therefore GAO, have access to cost records that directly pertain to the pricing of the contract involved—that is, to data which the contractor submits or should have submitted.[22] This is limited to factual data which is verifiable.[23] For example, internal budgets and profit plans are not considered factual and therefore are not accessible.[24]

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[22] *See* DAR 3-807; NASA PR 3.807. These regulations prescribe cost and pricing data which is or may be required to be submitted during negotiations and therefore is subject to record examination by DOD or NASA. Under DAR 3-807.1(a)(1), cost or pricing data consists of "all facts existing up to the time of agreement on price which prudent buyers and sellers would reasonably expect to have a significant effect on price negotiations." *See also* NASA PR 3.807-1(a)(1); FPR 1-3.807-3(h)(1).

[23] The contractor's obligation is limited to providing "*factual*" cost and pricing data; that is, "information which can be *verified*." DAR 3-807.1(a)(1) (emphasis added). The regulation does not require the contractor to make representations as to the accuracy of judgments it has made on the basis of such data and emphasizes that "[t]his distinction between fact and judgment should be clearly understood." DAR 3-807.6(b). *See also* NASA PR 3.807-6(b); FPR 1-3.807-3(h)(1). The limitation of examinable data to that which is factual has the acquiescence of Congress. *See Truth in Negotiations Act: Hearing on H.R. 10573 Before the Subcomm. of Special Investigations of the House Comm. on Armed Services*, 90th Cong., 2d Sess. 7573 (1968).

[24] *See* E-Systems, Inc., 74-2 B.C.A. (CCH) ¶ 10,782, *aff'd*, 74-2 B.C.A. (CCH) ¶ 10,943 (1974), where the Board held that the contractor's profit plan did not fall within the purview of the Truth in Negotiations Act provisions.

The GAO has acknowledged that the contractual access to records clauses do not obligate a contractor to make such internal management documents available for examination. *See* GAO, *Memorandum on the Adequacy of the Legal Authority of the General Accounting Office To Conduct a Comprehensive Study of Profitability in Defense Contracting, reprinted in* 115 Cong. Rec. 25,800 (1969); Letter from Elmer B. Staats, Comptroller Gen. of the United States, to Sen. William Proxmire, Chm., Jt. Econ. Comm. (Mar. 29, 1971) (GAO No. B-159896) (Exhibit PA 49, Deposition of Gregory J. Ahart); Memorandum from Paul G. Dembling, General Counsel

The extent to which DOD and NASA, and therefore the GAO, have a right of access to records of costs incurred during performance depends on the manner in which the contract price is established. If price is based in whole or in part upon such incurred costs—*e.g.*, a cost plus fixed-fee, cost sharing, time and/or materials, incentive or redeterminable price type contract—then DOD and NASA, and therefore the GAO, should and do have access to records regarding those costs.[25] If instead, the contract is fixed price in advance, and this is done on the basis of projected contractor costs, the government again has a right of access to cost records, but solely for the purpose of verifying the cost or pricing data submitted during negotiation of the contract.[26] This limitation is sensible. Under a fixed-price contract, the contractor has "full responsibility" for costs. Its cost experience during performance does not affect the price.[27]

Finally, if a negotiated contract is priced on the basis of catalog or market prices, as were Merck's, an exemption is provided from the right to examine cost records.[28]

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to Charles M. Bailey, Director, Defense Division (Sept. 8, 1970), Joint Appendix ("J.A.") 157a-58a; Memorandum from C. M. Bailey to General Counsel, No. B-159896(.07) (Oct. 22, 1970), J.A. 160a.

[25] For contracts in which price is dependent upon incurred costs, the right of access to records is set out in the contract clause required by DAR 7-104.41(b). *See also* NASA PR 7.104-42(b); FPR 1-3.814-2(b).

[26] DAR 3-807.10(c) defines the scope of examination of records pursuant to the contract clause required by DAR 7-104.41 in the case of cost-based, fixed-price contracts. This limits postaward cost performance audits to "determining whether or not defective cost or pricing data were submitted." *See also* NASA PR 3.807-10(c), 7.104-42(c); FPR 1-3.807-5(c), 1-3.814-2(c).

[27] DAR 3-404.2.

[28] *See* 10 U.S.C. § 2306(f)(2). Consistent with this provision, the contracting officer is normally not to request cost data for commercial items priced on the basis of catalog or market prices. *See* DAR 3-807.3(b) & (e), 3-807.6(d), 3-807.7(b)(7). *See also* NASA PR 3.807-3(b) & (e), 3.807-6(d), 3.807-7(b)(7); FPR

This too is a sensible rule. Neither projected nor incurred costs are a factor in the negotiation of the contract and its price.[29] The measuring yardstick, the contractor's catalog or market price,[30] is determined under

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1-3.807-3(f). DAR 3-807.3(e) allows the contracting officer to request cost data, subject to procedural safeguards. *See also* NASA PR 3.807-3(e); FPR 1-3.807-3(f)(1). This does not, however, provide a broad right of access to cost records. Rather, the contracting officer must articulate a specific factual basis for requesting cost data. *See* Sperry Flight Sys.—Div. of Sperry Rand Corp. v. United States, 548 F.2d 915, 922 (Ct. Cl. 1977). This exception would not apply to the pharmaceutical contracts at issue in this case. The GAO conceded that it had no basis for challenging the determination of the contracting officer that the Merck contracts fell within the Truth in Negotiations Act's exemption for contracts based on catalog or market prices. Deposition of Gregory J. Ahart, Ct. App. Appendix at 207, 213, 217. *See also id.* at 216; SmithKline Corp. v. Staats, 668 F.2d 201, 203 (3d Cir. 1981) (no reason to believe the contracts involved improprieties, excess or unfair profits, or other irregularities).

[29] Under the DAR, the contracting agencies may request "actual sales and other data *directly pertinent*" to establishing the existence of an established catalog or market price for the item being procured, *see* DAR 3-807.7(b)(7) (emphasis added), and *pricing* data necessary to determine the reasonableness, in light of the terms and conditions of the offer, of the price quoted to the government in comparison to that charged to the public. *See* DAR 3-807.7(b)(6). *See also* NASA PR 3.807-7(b)(6) & (7); FPR 1-3.807-1(b)(2). Such pricing data may include information regarding "the supplier's marketing system," "services normally provided commercial purchasers," "the normal quantity per order," and "the annual volume of sales to largest customers." *See* DAR 3-807.7(b)(6).

[30] The Comptroller General, at the time of the enactment of the Truth in Negotiations Act, recognized that a contractor's certification of cost data was not required where such data was not relied on in the negotiation of catalog price-based contracts. *See* Letter from Joseph Campbell, Comptroller General of the United States, to Sen. Richard Russell, Chm., Comm. on Armed Services (July 17, 1962), *reprinted in* S. Rep. No. 1884, 87th Cong., 2d Sess. 23 (1962). *See also* Comptroller General, *Report to the Congress of the United States, Need for Postaward Audits To Detect Lack of Disclosure of Significant Cost or Pricing Data Available Prior to Contract Negotiation and Award*, No. B-158193, Letter at 3 (1966).

the competitive forces of the commercial market.[31] Under these circumstances, the burden and expense of examination of cost records is not required because "the interaction of buyers and sellers in the marketplace will have done the job [of establishing a price that is fair and reasonable]." [32]

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[31] If the item being procured is not comparable to those sold commercially, then its price may not then be "based on" an "established" catalog or market price. This may serve as a basis for requesting cost data. *See* DAR 3-807.7(b)(3). *See generally* Sperry Flight Sys.—Div. of Sperry Rand Corp., 74-1 B.C.A. (CCH) ¶ 10,648 at 50,553-54 (1974), *aff'd*, 548 F.2d 915, 918 (Ct. Cl. 1977). In the usual case, such cost data is to be "limited to that pertaining to the differences between the items." DAR 3-807.7(b)(3). There is no suggestion of product differences in the record in this case to justify GAO's sweeping demand for access to Merck's cost records.

[32] *Armed Services Procurement Regulation Manual for Contract Pricing* 8A2 (1975 ed.) (*"ASPR Manual"*). The GAO has also recognized that with respect to such procurements, "[contracting] officials normally rely on the competitive forces of market rather than cost or pricing data in determining whether proposed prices are fair and reasonable." Appendix to the 1970 Comptroller Gen. Ann. Rep. 53 ("GAO Appendix"). *See also* Note, *Government Contracts: Contractor's Obligation To Allow Examination of Records Under 10 U.S.C. § 2313(b)*, 72 Dick. L. Rev. 687, 690-91 (1968) ("Note, *Government Contracts*"). The ASPR Manual also states that where the government "can buy at prices established in a marketplace, or at prices based on other prices that were set competitively, [the contracting officer] can use price analysis techniques to determine the reasonableness of [the] price." *ASPR Manual* at 8A2. DAR 3-807.1(a)(2) defines price analysis as "the process of examining and evaluating a prospective price *without* evaluation of the separate cost elements and profit proposed by the individual prospective supplier whose price is being evaluated." (Emphasis added.)

II. GAO'S RIGHT OF ACCESS TO COST RECORDS DOES NOT EXTEND BEYOND THE PRESENT BOUNDS ON DOD'S AND NASA'S RIGHT OF ACCESS

A. The Language Of Sections 2313(b) And 254(c) Establishes That GAO's Right Of Access To Cost Records Is Narrower Than DOD's And NASA's Under 10 U.S.C. § 2306(f)(3)

Construction of sections 2313(b) and 254(c) must begin with consideration of the statutory language. *See Southeastern Community College v. Davis*, 442 U.S. 397, 405 (1979). Their language is quite restrictive. This can be seen by comparing that language to the counterpart provision in 10 U.S.C. § 2306(f)(3). The latter gives DOD and NASA a right "to examine all . . . records . . . related to the negotiation, pricing, or performance of the contract or subcontract." The right of access to records given GAO under sections 2313(b) and 254(c) is much narrower. It does *not* extend to all cost records "related to" the contract or subcontract. Instead,

a) GAO has access only to cost records *directly pertaining* to the contract;

b) GAO's access to directly pertinent cost records is further limited to records which involve *transactions relating to* the contract; and

c) GAO's right of access does not expressly encompass records of the cost of performance of the contract.

This compels a conclusion that GAO does not have broader rights of access than section 2306(f)(3) grants to DOD and NASA.[33]

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[33] The limitations contained in §§ 2313(b) and 254(c) are unusual. Congress has placed these limitations in only three other statutes, 22 U.S.C. § 2586 (1976), 42 U.S.C. § 2206 (1976), and 50 U.S.C. § 1433(b) (1976), whereas some 51 other statutes granting GAO a right of access to records are not so limited. These 51 statutes are cited in Appendix A.

B. Sections 2313(b) And 254(c) And The Truth In Negotiations Act Are Similar In Purpose

There is a basic similarity of purpose behind sections 2313(b) and 254(c) and the Truth in Negotiations Act. Both statutes are expressly limited to negotiated procurements. Neither applies to contracts which are formally advertised. Both were enacted because of congressional concern as to the pricing of negotiated contracts for which price competition is inadequate. In the Truth in Negotiations Act, the statute itself permits waivers "where the price negotiated is based on adequate price competition [or] established catalog or market prices of commercial items sold in substantial quantities to the general public." [34]

The legislative history of sections 2313(b) and 254(c) evidences the same focus.[35] The legislation did not cover formally advertised contracts because of the competitive process controlling the award of such contracts. Congressman Hardy, the sponsor of this legislation, noted

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[34] 10 U.S.C. § 2306(f)(2). *See also* H.R. Rep. No. 1638, 87th Cong., 2d Sess. 1-3, 5-6 (1962); S. Rep. No. 1884, 87th Cong., 2d Sess. 3 (1962).

[35] Sections 2313(b) and 254(c) were based on a similar amendment (also sponsored by Rep. Hardy) to the First War Powers Act enacted nine months earlier. *See* 97 Cong. Rec. 13,198 (1951); S. Rep. No. 603, 82d Cong., 1st Sess. 1-2 (1951); H.R. Rep. No. 791, 82d Cong., 1st Sess. 1-2 (1951). The legislative history of the amendment to the First War Powers Act is therefore directly relevant in discerning the congressional purpose in enacting the amendments to §§ 2313(b) and 254(c). *See* Oscar Mayer & Co. v. Evans, 441 U.S. 750, 755-56, 758 (1979); Cannon v. University of Chicago, 441 U.S. 677, 694-98 (1979). The earlier legislative history demonstrates Congress' primary concern was with the negotiation and pricing of the contract in situations where there was not adequate price competition. *See* 96 Cong. Rec. 17,045 (1951) (remarks of Rep. Hardy). *See also id.* (remarks of Rep. Marcantonio); *id.* at 17,123 (remarks of Rep. Celler); S. Rep. No. 2686, 81st Cong., 2d Sess. 3 (1950); Act of Jan. 12, 1951, § 2, Pub. L. No. 81-921, 64 Stat. 1258 (1951).

that in advertised contracts, "there is a fixed price which is arrived at as a result of competitive bidding," 97 Cong. Rec. 13,199 (1951), and that this "generally operates as a brake on the *price* which a contractor can demand from the Government for his goods and services," *id.* at 13,198 (emphasis added). However, he was concerned lest the government "come out on the short end of the deal" in situations where prices were established through negotiation. *Id.* He advised that the bill would "enable the [GAO] to check the *transaction*, both from the Government records and the contractors' books." *Id.* (emphasis added).

That the congressional focus was on the pricing aspect of contract negotiation is also evident from the examples which were placed in the record by Congressman Hardy to explain why GAO should be provided access to records: the use of higher overhead rates in negotiating with the government than commercially; improper allocation of costs under cost-based contracts which have redeterminable prices; and failure to disclose that the contractor is selling another's product at a price above the producer's market price. *Id.*[36]

As this Court has recognized, a sponsor's statements of purpose are persuasive indications of congressional intent. *See Federal Energy Administration v. Algonquin SNG, Inc.*, 426 U.S. 548, 564 (1976).

C. GAO's Right Of Access To Cost Records Was Limited To "Directly" Pertinent Records In Order To Prevent Snooping

As originally proposed, the legislation which became sections 2313(b) and 254(c) granted GAO access to "pertinent" books and records. The word "directly" was

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[36] *See also* 97 Cong. Rec. at 13,198-99 (1951), where Congressman Hardy stated that the access provisions would not apply to advertised contracts because of the manner in which they were priced.

added by floor amendment. Congressman Hoffman, the sponsor of the amendment, objected to the access to records provisions as giving the GAO "unlimited authority to go everywhere and snoop into everybody's business." 97 Cong. Rec. 13,373 (1951). "To limit the 'snooping' that [could] be carried on under this bill," GAO's right of access was narrowed to records that were "*directly* pertinent" to the contract. *Id.* at 13,377 (emphasis added).[37]

D. The GAO Has Recognized That The Government's Interest Is In Examining Cost Records To The Extent Costs Are Directly Pertinent To The Pricing Of The Contract

Four years after enactment of sections 2313(b) and 254(c), the GAO stated that

> [t]he examination of contract activities is concerned primarily with the operation and administration of those types of negotiated contracts under which the Government has a financial interest in the *cost of performance.* They usually are cost-reimbursement-type contracts and the various forms of price redetermination or incentive contracts under which the ultimate *price is materially affected by costs of performance.*[38]

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[37] Congressman Hoffman, criticizing the bill before its amendment, also commented that the "bill under the guise of doing something to protect the taxpayers . . . would let the GAO go into everybody's business and look it over *if they just want to take a look at it.*" 97 Cong. Rec. at 13,373 (emphasis added). This is a further indication that his amendment adding the word "directly" to the statute was intended to limit GAO's right of access.

[38] 1955 Comptroller Gen. Ann. Rep. 22 (emphasis added). The Annual Report for 1956, relied on by the government, Brief at 26, also emphasized that the government's interest was in contracts "negotiated largely on the basis of actual or estimated cost." 1956 Comptroller Gen. Ann. Rep. 23. Neither report mentions contracts based on catalog or market prices. *See also* 1962 Comptroller Gen. Ann. Rep. 91-97; 1959 Comptroller Gen. Ann. Rep. 85-96; 1953 Comptroller Gen. Ann. Rep. 29; Dembling Affidavit, J.A. 21a-

Subsequently, Comptroller General Campbell described the nature of GAO's audits of negotiated contracts in language which virtually tracks the limits discussed above on DOD's and NASA's right of access to records:

> Audits of negotiated contracts may involve a review of the contractor's cost representations and pricing proposals, a comparison of the contractor's cost estimates with his previous cost experience, a comparison of his cost estimates with costs actually incurred in the performance of the contract, *and an audit of costs incurred in those cases in which reimbursement or the prices paid by the Government are based on or are affected by actual costs.*[39]

Sections 2313(b) and 254(c) were first enacted thirty-one years ago, in 1951. To the best of AIA's knowledge, GAO's practice since then, except for the few litigated cases, has conformed to those early policy pronouncements and has not included examination of cost records of contracts with AIA members for commercial items sold in substantial quantities to the general public priced on the basis of catalog or market prices.[40]

23a, and Defendants' Response to Plaintiff's Second Set of Interrogatories, J.A. 46a. *Cf.* F. Mosher, *The GAO: The Quest for Accountability in American Government* 152 (1979), indicating that §§ 2313(b) and 254(c) gave GAO access to records of *cost based* contracts.

[39] *Comptroller General Reports to Congress on Audits of Defense Contracts: Hearings Before a Subcomm. of the House Comm. on Government Operations*, 89th Cong., 1st Sess. 42 (1965) (emphasis added). *See also* GAO Appendix 53.

[40] Sixteen years after the enactment of §§ 2313(b) and 254(c), the GAO was unable to point to a single case other than *Hewlett-Packard*, where it had asserted "the 'right' to examine cost records relating to a firm fixed-price contract for standard commercial articles negotiated on the basis of established market prices without consideration of cost data during the negotiations." Godown, *"Price Control" Ploy*, 12 NAM Reports 13, Aug. 21, 1967. *See also* Letter from Frank H. Weitzel, Asst. Comptroller Gen., to Rep. Henry P. Smith at 2-3 (Oct. 12, 1967) (No. B-146767) (Exhibit PA52, Deposition of Gregory J. Ahart).

E. The Established Limitations Upon The Government's Right To Examine Are A Reasonable And Sensible Interpretation Of Sections 2313(b) And 254(c)

As previously noted, both the language and the legislative history of sections 2313(b) and 254(c) demonstrate that Congress did not intend to give the Comptroller General a blank check in obtaining access to records. In the litigation to date, the difficulty for the lower courts has been where to draw the line. The district court in *Eli Lilly & Co. v. Staats*, No. IP-72 (S.D. Ind. 1976), *rev'd*, 574 F.2d 904 (7th Cir.), *cert. denied*, 439 U.S. 959 (1978),[41] was the first to consider the scope of GAO's right of access in the context of GAO's investigation of the profits of the pharmaceutical industry.[42] The district court enjoined the Comptroller General from examining any of the cost records requested from Eli Lilly, concluding that such records

> do not directly pertain to, and involve transactions relating to, the particular types of negotiated contracts involved in this suit.[43]

The next decision regarding the pharmaceutical industry was by the district court in *Bristol Laboratories*

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[41] The opinion of the district court in *Eli Lilly* is reprinted at 574 F.2d 919-26 as an appendix to the dissenting opinion of Judge Pell.

[42] Earlier, in Hewlett-Packard Co. v. United States, 385 F.2d 1013 (9th Cir. 1967), *cert. denied*, 390 U.S. 988 (1968), the court of appeals affirmed a district court decision that granted the GAO access to records relating to the production cost of test and measurement equipment under four contracts priced on the basis of catalog prices. The decision did not explain what costs were encompassed in the term "production costs." The court does not appear to have been fully aware of the fact that sensible and broadly accepted delineations of bounds upon the government's right to examine generally were in place. *See generally* 385 F.2d at 1014-15 & n.3.

[43] 574 F.2d at 925. The district court in effect held that the GAO was entitled to access only to those records which would have been available to the contracting agencies under the Truth in Negotiations Act for contracts based on catalog or market prices. *See id.* at 925-26.

Division of Bristol-Myers Co. v. Staats, 428 F. Supp. 1388 (S.D.N.Y. 1977), *aff'd*, 620 F.2d 17 (2d Cir. 1980), *aff'd by an equally divided court*, 451 U.S. 400 (1981). Bristol had been awarded four negotiated contracts for pharmaceutical products priced on the basis of commercial prices. Bristol had volunteered to allow examination of its manufacturing costs, manufacturing overhead, royalty expense, and delivery costs. The GAO sought access to essentially all of Bristol's cost records. The district court rejected GAO's position as "distortion of the language" of sections 2313(b) and 254(c):

> The reasonable assumption is that if Congress had wished to condition receipt of a fixed-price negotiated contract on the contractors' agreement to allow such unusual and unfettered government inspection of their business records, it would have done so explicitly.

428 F. Supp. at 1390. The district court went on to hold that the GAO was not entitled to access to cost records beyond those volunteered by Bristol.

Since those two decisions, a disagreement has arisen in the courts of appeals. *Bristol* was unanimously affirmed by the Second Circuit and was followed by the Third Circuit in *SmithKline Corp. v. Staats*, 668 F.2d 201 (3d Cir. 1981), and by the panel majority of the court of appeals in this case. On the other hand, a divided panel of the Seventh Circuit in *Eli Lilly*, *supra*, allowed the GAO its entire request to examine records. That court reached the same result in *United States v. Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979), but with two of the three members of the panel indicating they were concurring only because of the earlier decision in *Eli Lilly*.[44]

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[44] In *Bristol*, the Second Circuit squarely rejected the reasoning of the Seventh Circuit in *Eli Lilly* and *Abbott Laboratories*. 620 F.2d at 18. According to one commentator, "[t]he *Lilly* rule, with its virtually unlimited scope of access, gives no effect to the 'directly pertinent' restriction and is therefore at variance with the will of Congress." Note, *Eli Lilly & Co. v. Staats: An Undue Expansion*

The dilemma which has confronted the courts of appeals—that of where to draw the line on the GAO's right of access to cost records—was well summarized in *SmithKline*. The court explicitly recognized that Congress had not given the GAO an unlimited right of access:

> The legislative history manifests a strong congressional intent to prevent unlimited "snooping." "[W]hen Congress enacts a statute designed to limit government intrusion in the private affairs of its citizens, the statutory provisions must be followed scrupulously." *United States v. Bacheler*, 611 F.2d 443, 447 (3d Cir. 1979). We thus conclude that the contract does not provide for unlimited access to SmithKline's cost records.

668 F.2d at 210.

For this reason, the court denied the GAO the broad access it seeks here:

> We believe that the Government's argument undermines its own position, for it would seem that the Government's interpretation of "directly pertinent" admits of no doctrinal limitation on its access powers. We are unwilling to read the statutory provision as granting to GAO such broad discretion in determining what is pertinent and what is "snooping." The Government has not suggested a definition of "directly pertinent" that preserves the distinction between snooping and properly limited access. Indeed, its argument gives the phrase no effect in this case.

Id. at 211. However, the court was also concerned that if some access to cost records was not allowed, "the provision for access to . . . records . . . would be a nullity." *Id.* at 208.

The court of appeals in *SmithKline* correctly rejected the government's expansive interpretation of the access to records clauses. However, its latter concern with where

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of the GAO's Investigatory Power Under the Access-to-Records Statutes, 74 Nw. U.L. Rev. 122, 136 (1979) ("Note, *Eli Lilly & Co. v. Staats*").

to draw the line so as to give meaning to the contract clauses required by sections 2313(b) and 254(c) was misplaced. As previously seen, sensible bounds upon contracting agencies' right to examine contractor cost records have long been established. They are a reasonable and cost-effective interpretation of sections 2313(b) and 254(c). They provide GAO with access to cost records to the extent contractor costs directly pertain to the pricing of a negotiated contract: If the contract price depends in part or in whole upon incurred costs of performance, the government has access to the cost records involved.[45] If the price is fixed in advance based upon cost estimates, there is a limited right of access to cost records for the sole purpose of verifying the original pricing of the contract. If the price is based on catalog or market prices, there is no right of access to cost records, since they are not directly pertinent to the contract.[46] Moreover, these existing bounds are in accord with what GAO for many years articulated as sound practice. GAO's right of access should not extend beyond these bounds.

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[45] The government points out, Brief at 38 & n.21, that the procurement regulations cover the allocation and allowability of costs under *cost-based* contracts. *See* DAR 15-000-809.5; NASA PR 15.000-809-4; FPR 1-15.000-713-9. However, it errs in suggesting that the existence of such regulations for cost-based contracts implies that cost records are therefore "directly pertinent" to catalog or market price based contracts.

[46] *See* Eli Lilly v. Staats, 574 F.2d at 919 (Pell, J., dissenting). *See also* Note, *Government Contracts*, 72 Dick. L. Rev. at 690-91. As indicated above, the contracting agency, and therefore GAO, is entitled to access to pricing data sufficient to determine that the price negotiated is in fact "based on . . . *established* catalog or market prices of *commercial* items sold in *substantial quantity* to the general *public*." 10 U.S.C. § 2306(f)(2) (emphasis added). *See generally* GAO Appendix 53-54. Failure to satisfy these conditions may provide a basis for requesting cost data. However, where they are satisfied, "[f]ederal procurement statutes presume that . . . the workings of the marketplace produce fair and reasonable prices." *ASPR Manual* at 8A2. *See also* GAO Appendix 53.

This interpretation gives full and reasonable meaning to all of the language of sections 2313(b) and 254(c)—both to the words of limitation and to the choice of the word "contract" as the focal point of the right of access.[47] 10 U.S.C. § 2306(f)(3) shows that when Congress intends to include performance *per se* within the scope of a right of access, it does just that. The language of sections

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[47] The meaning of the word "contract" as used in §§ 2313(b) and 254(c) was at issue in Hewlett-Packard Co. v. United States, 385 F.2d at 1016:

> The key word in the limitation clause is "contract." If that word is used in section 2313(b) only with reference to the terms and conditions of an agreement and the procedures whereby those terms and conditions were formulated, then the district court failed to give full effect to the limitation clause. As Hewlett-Packard correctly points out, under the stipulated facts summarized above, production costs were not taken into consideration in arriving at the terms and conditions of the contracts in question. Thus data pertaining to production costs could not be said to directly pertain to, and involve transactions relating to, the contract, as so defined.

The Ninth Circuit then concluded:

> In our opinion, however, the word "contract," as used in this statute is intended to have a broader meaning, embracing not only the specific terms and conditions of the agreement, but also the general subject matter.

Id. This conclusion is erroneous. First, it fails to give "contract" its normally understood meaning. *See Webster's Third New International Dictionary* 494 (1969). *See also* Eli Lilly v. Staats, 574 F.2d at 919 (Pell, J., dissenting, characterizing the Ninth Circuit's interpretation of "contract" as "tortured"); Note, *Eli Lilly & Co. v. Staats*, 74 Nw. U.L. Rev. at 130-31 & n.55. Second, in § 2313(b) Congress required an access to records clause to be inserted in "each *contract*," *i.e.*, in the agreement itself. (Emphasis added.) As this Court has stated in another context, the Ninth Circuit's interpretation of the subsequent reference to "contract" in the statute leads to the "hardly credible [conclusion] that Congress used th[is] term . . . in different senses in the same sentence." United States v. Cooper Corp., 312 U.S. 600, 606 (1941). There is no basis in either the language of the statute or its legislative history to depart from the normal meaning of "contract." *See* Perrin v. United States, 444 U.S. 37, 42 (1979); Burns v. Alcala, 420 U.S. 575, 580-81 (1975).

2313(b) and 254(c) limiting access to records that "directly pertain to, and involve transactions relating to the contract" is far more restrictive. If Congress wanted to grant an unlimited right to examine cost records, it would have used less confining language. Therefore, under the clauses required by sections 2313(b) and 254(c), records of incurred costs are directly pertinent to the contract only to the extent the price is measured by reference to those costs.

F. As A Matter Of Contract Interpretation, GAO's Rights Under The Access To Records Clauses Do Not Exceed The Bounds Placed On DOD And NASA

AIA respectfully submits that the issue here is one of contract interpretation as well as statutory interpretation. Sections 2313(b) and 254(c) are of unusual form. They do not directly provide for a right of access by the Comptroller General. Instead, they require contract clauses creating that right.[48] To the extent that the bounds upon GAO's right of access were left imprecise by the legislation and its legislative history, canons of construction for contracts apply.[49]

The clauses at issue were drafted and required by the government. A fundamental canon of construction is that where an ambiguity exists in such a clause, a reasonable interpretation by the contractor controls.[50]

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[48] 10 U.S.C. § 2306(f)(3), for example, itself creates the right of examination for the DOD and NASA.

[49] *See* Bristol Labs. v. Staats, 428 F. Supp. at 1390-91. *See also* Eli Lilly v. Staats, 574 F.2d at 918; Ferguson v. Union Nat'l Bank, 126 F.2d 753, 755-56, 758 (4th Cir. 1942). *But see* Merck & Co. v. Staats, 665 F.2d at 1248, Pet. App. 26a-27a (Mikva, J., concurring and dissenting). In the court of appeals, the government relied heavily on the theory that the GAO was entitled to cost records as a matter of contract interpretation. *See* Brief for Appellees and Cross Appellants, Merck & Co. v. Staats, 665 F.2d 1236, at 18-22.

[50] *See generally, e.g.*, United States v. Seckinger, 397 U.S. 203, 210 (1970); WPC Enters. v. United States, 323 F.2d 874, 876 (Ct. Cl. 1963); Cutler-Hammer, Inc. v. United States, 416 F.2d 1306, 1318 (Ct. Cl. 1969) (Nichols, J., concurring and dissenting); Ferguson

The government contends that in contracts priced on the basis of catalog or market prices, the clauses "should be construed to authorize the Comptroller General to examine all of a contractor's cost records that are *necessary* and *appropriate* to determine whether the price charged the government was 'extravagan[t],' 'excessive,' or 'wasteful[].'" Brief at 32-33 (emphasis added). This is not what the clauses required by sections 2313(b) and 254(c) provide. Nor, when it entered the contracts, did Merck believe those clauses gave the GAO that right.[51] As the district court in *Bristol, supra*, aptly noted, construing this clause as a matter of contract interpretation

> turns on the intent and understanding of the parties regarding the import of the access to records clause at the time the contracts were entered. The government's position is particularly unrealistic when viewed in this light. It is inconceivable that Bristol, or any contracting firm, could have understood this clause to authorize the sweeping power of inspection claimed by the GAO. As a matter of contractual construction, the government's argument falls of its own weight.

428 F. Supp. at 1390-91. Merck's interpretation was reasonable and in accord with established practice.[52] That interpretation is the one that controls.

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v. Union Nat'l Bank, 126 F.2d at 758—all applying doctrine of *contra proferentem* against the government. *See also* S&E Contractors, Inc. v. United States, 406 U.S. 1, 20 (1972) (Blackmun, J., concurring); Cole v. Young, 351 U.S. 536, 556 (1956); Hills Transp. Co. v. United States, 492 F.2d 1394 (Ct. Cl. 1974). *But see* Cutler-Hammer, Inc. v. United States, 416 F.2d at 1316-17 n.1 (Davis, J., concurring and dissenting).

[51] *See* J.A. 25a.

[52] Judge Mikva and the Seventh Circuit incorrectly suggest that contractors had notice that GAO broadly interpreted its right of access to cost records after the decision in *Hewlett-Packard*. *See* 665 F.2d at 1248 n.30, Pet. App. 28a n.30; Eli Lilly v. Staats, 574 F.2d at 918. As the GAO has acknowledged, notwithstanding its position as to the records encompassed by its demand in *Hewlett-Packard*, the decision in that case granted access *only* to records of

III. GAO'S DEMAND FOR ACCESS IS NOT FOR A LEGITIMATE AGENCY PURPOSE AND THEREFORE IS NOT ENFORCEABLE

The GAO's demand for cost records is fatally defective not only because it seeks records which do not directly pertain to the type of contract involved, but also because it is for an improper agency purpose.[53] Sections 2313(b) and 254(c) limit the GAO's access to records which are directly pertinent and involve transactions related to the

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"production costs." See 1968 Comptroller Gen. Ann. Rep. 8. *See also Hearings on Comptroller General Reports to Congress on Audits of Defense Contracts, supra* note 39, at 45-46. Therefore, as the district court in *Bristol* properly concluded, it is "inconceivable that [a contractor] could have understood this clause to authorize the sweeping power of inspection claimed by the GAO." 428 F. Supp. at 1390-91. It is also incorrect to suggest, as the government did below (see Brief for Appellees and Cross Appellants at 20) that its interpretation represents a well-established judicial construction of the clause. As Judge Mikva acknowledged, the courts, when confronted with demands for access identical to those in *Hewlett-Packard*, have themselves disagreed over the meaning of that decision. *See* 665 F.2d at 1248 n.27, Pet. App. 26a n.27. *See also* SmithKline Corp. v. Staats, 668 F.2d at 213; Eli Lilly v. Staats, 574 F.2d at 918-19 (Pell, J., dissenting); Bristol Labs. v. Staats, 428 F.2d at 1391.

[53] The GAO is bound by the rule requiring a legitimate agency purpose for an investigative demand by a government agency. *See* United States v. Morton Salt Co., 338 U.S. 632, 652-53 (1950); Oklahoma Press Publishing Co. v. Walling, 327 U.S. 186, 209 (1946); CAB v. United Airlines, Inc., 542 F.2d 394, 398 (7th Cir. 1976); American Int'l Trading Co. v. Bagley, 536 F.2d 1196, 1198 (7th Cir. 1976). *See also* 1 K. Davis, *Administrative Law Treatise* § 3.10 at 210 (1958). This is true even though it was created as an independent agency within the legislative branch. *See* Cibinic & Lasken, *The Comptroller General and Government Contracts*, 38 Geo. Wash. L. Rev. 349, 349-50 & n.3 (1970). The GAO itself does not claim it is carrying out a duly authorized legislative investigation. There was no formal action or request by the Congress or one of its committees or subcommittees. Instead, the GAO is invoking a specific statutory authority and must remain within the confines of that authority. *See* Comment, *The Comptroller General's Authority to Examine the Private Business Records of Government Contractors: Eli Lilly & Co. v. Staats*, 92 Harv. L. Rev. 1148, 1156 (1979); Note, *Eli Lilly & Co. v. Staats*, 74 Nw. U.L. Rev. at 126 n.25.

contract. The legislative history makes clear that the purpose of the two sections was to allow GAO to examine records pertaining to the negotiation and pricing of particular negotiated contracts.[54] GAO's request to examine Merck's records, however, was part of a broader investigation directed at the records of six pharmaceutical manufacturers. The investigation was the direct consequence of the interest of certain congressmen in the profit levels of the pharmaceutical industry. Nothing in sections 2313(b) and 254(c) or their legislative history justified or authorized their being used for such a purpose.

Congressional action since the enactment of sections 2313(b) and 254(c) confirms that GAO lacks authority under those statutes to conduct studies of industry profit levels. Congress, in the Military Appropriations Act of 1970, explicitly granted GAO authority to conduct a single study of defense industry profits.[55] The legislative history of that Act indicates that special legislation was required because both Congress [56] and the GAO [57] believed

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[54] The fact that a contractor has agreed to give the GAO access to records directly pertinent to, and involving transactions relating to, the contract in no way implies that the contractor has waived the requirement that the GAO act with a proper purpose. *See* United States v. Mississippi Power & Light Co., 638 F.2d 899, 906 n.11 (5th Cir. 1981), *cert. denied*, 102 S. Ct. 387 (1981); First Ala. Bank v. Marshall, 26 Fair Empl. Prac. Cas. (BNA) 388, 392 (N.D. Ala. 1981).

[55] *See* Pub. L. No. 91-121, § 408, 83 Stat. 204, 208 (1969). The authority for this single study expired after one year. *See also* 115 Cong. Rec. 25,793-94 (1969) (statement of Sen. Proxmire); *id.* at 25,795 (statement of Sen. Ribicoff).

[56] Senator Proxmire, the sponsor of the provision authorizing this study, stated:

> These summarize part of my argument for a defense profit study. This argument is buttressed by the lack of authority that now exists within the General Accounting Office to conduct a profit study. My amendment would correct this absence of authority ....

115 Cong. Rec. 25,800 (1969). *See also id.* at 25,795, 25,797.

[57] Senator Proxmire placed into the Congressional Record a *Memorandum on the Adequacy of the Legal Authority of the Gen-*

that the GAO lacked authority to conduct such a study under the access to records clauses required by sections 2313(b) and 254(c). Moreover, on two subsequent occasions,[58] Congress failed to enact legislation proposed by GAO which would have expanded its access to records authority in order to conduct profit studies of other large defense contractors.[59]

GAO has contended that its purpose is to determine the adequacy of the pricing method for the negotiated contracts involved. A first answer to this is that the record shows otherwise. The real motive has been the interest of a few congressmen in the profit levels of the pharmaceutical companies.

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eral Accounting Office to Conduct a Comprehensive Study of Profitability in Defense Contracting prepared by the GAO, 115 Cong. Rec. at 25,800-01 (1969). In that Memorandum, the GAO acknowledged that its right to examine contractor records was based on the access to records clause required by § 2313(b) but stated that "[w]hile [its] legal authority would permit it to perform some of the work necessary in making a profit study, *we do not think our authority is adequate.*" 115 Cong. Rec. 25,801 (emphasis added). The GAO specifically noted, *inter alia*, that it "has no right of access to records . . . concerning the commercial business of a defense contractor." *Id.*

[58] *See* S. 2049, 93d Cong., 1st Sess. (1973); S. 3014, 93d Cong., 2d Sess. (1974); S. 2268, 94th Cong., 1st Sess. (1975).

[59] The government contends, Brief at 25-32, that its sweeping interpretation of GAO's right of access represents a consistent and long-standing construction that Congress has recognized and never disapproved. If this were true, it would not have been necessary to seek special legislation to conduct industry profit studies. The government premises its argument on generalized statements regarding GAO's authority to examine government financial activity and on self-serving testimony in the mid-1960's, more than a decade after enactment of §§ 2313(b) and 254(c), designed to support its demand for records from Hewlett-Packard. As indicated in Part IID *supra*, GAO's own statements in the 1950's, which are more contemporaneous than those relied on by the government, indicate that GAO understood the statutes to confer a more limited right of access.

Secondly, the focus of the statute and its legislative history is upon the records directly pertinent to the pricing and negotiation of particular contracts. Neither the statutory language nor its legislative history supports the proposition that Congress intended to authorize broad GAO studies of overall procurement policies and procedures under sections 2313(b) and 254(c).[60] This does not foreclose GAO from investigating procurement decisions and informing Congress of its conclusions on the basis of records directly pertinent to the type of negotiated contracts involved. Rather, the requirement of a proper purpose only precludes GAO, in relying on the access to records authority granted by sections 2313(b) and 254(c), from extending an investigation into records which are not directly pertinent to the particular negotiated contract.

CONCLUSION

AIA urges that the judgment of the court of appeals, insofar as it allows the GAO access to Merck's cost records, be reversed on the basis of the statutory and contractual interpretation set forth above.

Respectfully submitted,

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[60] *See generally* Note, *Government Contracts*, 72 Dick. L. Rev. at 691; Note, *Eli Lilly & Co. v. Staats*, 74 Nw. U.L. Rev. at 138. *See also* SmithKline Corp. v. Staats, 668 F.2d at 205.

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Amicus Brief

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No. 81-1273

IN THE
Supreme Court of the United States

OCTOBER TERM, 1981

CHARLES A. BOWSHER,
COMPTROLLER GENERAL OF THE UNITED STATES,
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v.

MERCK & CO., INC. *Respondent*

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v.

CHARLES A. BOWSHER,
COMPTROLLER GENERAL OF THE UNITED STATES,
AND UNITED STATES OF AMERICA, *Respondents*

On Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

BRIEF FOR SMITHKLINE CORPORATION AMICUS CURIAE

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On Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF FOR SMITHKLINE CORPORATION AMICUS CURIAE

SmithKline Corporation ("SmithKline")[1] submits this brief amicus curiae[2] supporting in part the judgment of

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[1] Since the decision below in SmithKline's case, SmithKline's corporate name has been altered to SmithKline-Beckman Corporation. Its non-wholly-owned subsidiaries and affiliates, listed here in conformity with Rule 28.1, are Allergan S.A.; Allergan Canada; Allergan de Colombia S.A.; Allergan Ltd.; Allergan Productos Farmaceuticos Ltd.; Pharma-Allergan Vertrieb GmbH; Sauten-Allergan; Nelson Res. & Dev. Co.; Charles Rives Part.; Xonics Inc.; Branson Sonic Power S.A.; Edmonton Labs. Ltd.; Franklin Off. Assoc.; Franklin Partnership; Franklin Plaza Assoc.; Franklin Town Corp.; K.B.S.A.; Krautkramer Japan Co.; MedLab Holdings; Oak Internat'l Ltd.; SmithKline Instru. Co.; Walnut Ins. Co.; Wells-Krautkramer Ltd.; Branson Sonic Power Co. (S.A.) (Pty.); A. J. White Pty.; SK&F Labs, S.A.; SmithKline-RIT; SmithKline & French Canada Ltd.; Menley & James Ltd.; Surel Sutures; Laboratories SmithKline & French S.A.; SmithKline & French Laboratories Ltd.; SmithKline & French Pension Trustees Ltd.; SmithKline & French Research Ltd.; Laboratories Gremy-Longuet; SmithKline Dauelsberg GmbH; SmithKline & French Hellas S.A.; SK&F India; Chemico Pharmaceuticals; SmithKline & French S.p.A.; Labs Julian de Mexico; Norden de Mexico; SmithKline & French Nigeria; SmithKline & French of Pakistan; Cainta Realty Corp.; SmithKline & Fujisawa K.K.; Fujisawa SmithKline Corp.; SmithKline & French (Victoria Valley); SmithKline & French Portgueso Productos Farmaceuticos; A. S. Ruffel (Private) Ltd.; SmithKline Animal Health (S.W.A.) Ltd.; SmithKline Antibioticos S.A.; SmithKline & French (Switzerland) Ltd.; SmithKline Dauelsberg Verwaltan GmbH; SmithKline & French S.A.; Beckman Instruments Process-Gerate GmbH; Beckman Instruments Analytiques S.A.; Beckman Instruments International, S.A.; Beckman Instruments France S.A.; Beckman Instruments (Holding) Ltd.; Beckman Instruments Ltd., Beckman Instruments (Nederland) B.V.; Beckman Instruments (Belgium) S.A.; Beckman - RJJC Limited; Beckman Instruments (Hong Kong) Ltd.; BICOMP, S.A. de C.V.; Beckman Instruments de Mexico, S.A. de C.V.; Beckman Instruments (Proprietary) Limited; Beckman (UK) Pension Trustees Limited; Beckman Instruments (Australia) Pty. Ltd.; Beckman Instruments Superannuation Pty. Ltd.

[2] Letters from the parties consenting to the filing of this brief have been lodged with the Court.

the Court of Appeals for the District of Columbia Circuit, and urging its modification in part.

Interest of Amicus Curiae

Like respondent Merck & Co., Inc. ("Merck"), SmithKline is a manufacturer of pharmaceutical products. In August 1974, SmithKline, Merck and four other pharmaceutical manufacturers received identical letters from the Comptroller General demanding access to records relating to specific contracts for the sale of products to federal agencies.[3] The companies were singled out for this purpose because they had previously provided information voluntarily to the General Accounting Office ("GAO").[4] GAO had sought such information in obedience to the insistent demands of two Senators and their staff aides.[5] When the companies declined to provide further information without guarantees of confidentiality, the Comptroller General asserted a right to compel disclosure, based upon access-to-records provisions included in the contracts pursuant to 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c) (hereinafter the "access statutes").

GAO's purpose is not to audit the specific contracts upon which it relies.[6] The SmithKline contracts were

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[3] The letter to SmithKline is reproduced at page 60 of the Joint Appendix (hereinafter "C.A. App.") in *SmithKline Corp.* v. *Staats*, 668 F.2d 201 (3d Cir. 1981), *cert. pending*, No. 81-2082, *cross-petition pending*, No. 81-2268. A copy of the decision of the Third Circuit is contained in the appendix to this brief (hereinafter "App.").

[4] *SmithKline Corp.* v. *Staats*, 668 F.2d at 203; App. at 4a.

[5] It was the purpose of Senators Nelson and Kennedy to obtain confidential cost data "without strings attached" so "specific price and cost data" could be "publicize[d]." *Id.* at 3a-4a.

[6] *Id.* at 4a-5a.

selected essentially at random, merely as a vehicle to permit GAO to assert whatever rights it may have under the access statutes.[7] GAO has expressly disavowed any claim that SmithKline made any excess or undue profit or that any impropriety has or might have occurred.[8] Instead, GAO seeks to use the contracts to force the disclosure of virtually all of SmithKline's confidential cost data, relating to commercial as well as governmental business, and without any other definable limits or exceptions. GAO would use the data in an industry-wide study of the economics of pharmaceutical manufacturing.[9]

SmithKline offered to show GAO any documents that are, as the access statutes contemplate, "directly pertinent" to and involve "transactions relating to" the SmithKline contracts selected by GAO. When GAO persisted in its sweeping demand for virtually all of SmithKline's confidential cost records, SmithKline, like Merck, initiated an action seeking declaratory and injunctive relief. On December 28, 1981, the Third Circuit rejected GAO's interpretation of the access statutes, and limited the categories of records to which GAO could compel access.[10] The decision of the Third Circuit is consistent with those of the

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[7] *See* the parties' stipulation reproduced at C.A. App. 402. *See also id.* at 99-100, 106-108, 365. The stipulation makes clear that the same methods were used to select the Merck contracts.

[8] *Id.*

[9] *SmithKline Corp.* v. *Staats*, 668 F.2d at 203; App. at 4a.

[10] *SmithKline Corp.* v. *Staats*, 668 F.2d at 212-14; App. at 25a-28a. As noted above, the Court now has pending before it cross-petitions for certiorari. Nos. 81-2082 and 81-2268 (filed May 10 and June 10, 1982). In its cross-petition, SmithKline has urged the Court to set the case for argument with *Merck*.

District of Columbia Circuit in *Merck* and the Second Circuit in *Bristol.*[11]

The position presented here by SmithKline is similar to that offered by Merck. For reasons set forth below, SmithKline urges that the decisions in *Merck* and *SmithKline* should be modified to deny GAO access to any cost data or, in the alternative, that the decisions should be affirmed.

SUMMARY OF ARGUMENT

The language, legislative history and consistent interpretation of the access statutes show that they do not require the disclosure of cost data where procurement contracts are not cost-based. In such situations cost data are not offered or relied upon by the contractor and are not sought or relied upon by the agency. The prices in such contracts are not determined on the basis of cost, but by reference to standard catalogs or other evidence of the prices at which the goods are sold commercially. In such circumstances, cost data cannot be "directly pertinent" to the contract, or involve "transactions relating to" the contract.

The language, legislative history and consistent interpretation of the access statutes also show that they were never intended for the purpose now contemplated by GAO. The access statutes permit only the audit of specific contracts to detect fraud or other improprieties. No such conduct is claimed here, and GAO's purpose is not to audit the contracts upon which it relies. GAO seeks

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[11] *Bristol Laboratories* v. *Staats*, 428 F. Supp. 1388 (S.D.N.Y. 1977), *aff'd*, 620 F.2d 17 (2d Cir. 1980), *aff'd by an equally-divided court*, 451 U.S. 400 (1981).

instead to satisfy the demands of two Senators through an industry-wide study of the economics of pharmaceutical manufacturing. Prior to this litigation, GAO never claimed that the access statutes permit such studies, and, except in one specific situation irrelevant here, Congress has consistently refused GAO authority to conduct such studies.

Even if GAO could compel the disclosure of cost data in connection with non-cost-based contracts in order to conduct an industry-wide economic study, any such right should be restricted to documents reflecting the direct production costs of the specific products sold to the government. The Second, Third and District of Columbia Circuits have all adopted such a standard. The Seventh Circuit's contrary decision has been disapproved by two judges of that court.

ARGUMENT

I.

Cost Records Cannot Be "Directly Pertinent" to Non-Cost-Based Contracts

Under the access statutes, GAO's rights are expressly limited to documents that "directly pertain" to and involve "transactions relating to" a specific "contract." The Second, Third and District of Columbia Circuits have all held these to be important words of limitation.[12] The language and legislative history of the limitations show

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[12] *SmithKline Corp.* v. *Staats*, 668 F.2d at 212-14, App. at 25a-28a; *Merck & Co., Inc.* v. *Staats*, 529 F. Supp. 1, 2-3 (D.D.C. 1977), *aff'd*, 665 F.2d 1236 (D.C. Cir 1981), *cert. granted*, 102 S.Ct. 1968 (1982); *Bristol Laboratories* v. *Staats*, 620 F.2d at 18. Although a more expansive view of GAO's rights was taken in *Eli Lilly & Co.* v.

clearly that they do not permit access to cost data in connection with non-cost-based contracts.

The access statutes derive from similar legislation enacted during the Korean War. Pub. L. No. 82-245, 65 Stat. 700 (1951). Adopted as amendments to the First War Powers Act, 64 Stat. 1257 (1951), the legislation gave GAO power to determine whether contractors who negotiated emergency price changes because of inflationary cost increases had been guilty of "fraud or overreaching" or "anything untoward" in their cost representations. 96 Cong. Rec. 17123 (1951) (remarks of Rep. Celler). In the same year, the access statutes extended the same investigatory power to contracts entered into under other procurement statutes. The purpose of the access statutes was identical to that of the amendments to the First War Powers Act.[13]

The sponsor of the access statutes declared that they would enable GAO to "make effective audits," to "check the transaction" and thus to exercise more effectively its power to challenge "erroneous or illegal payments." 97 Cong. Rec. 12611, 13198, 13197 (1951) (remarks of Rep. Hardy). Congress was, however, fearful that GAO might abuse its access authority. Accordingly, amendments were adopted on the House floor to limit GAO's rights only to "directly" pertinent records, and to require GAO to exercise its authority, if at all, within three years after final payment under the contract. It was Congress' pur-

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Staats, 574 F.2d 904 (7th Cir.), *cert. denied*, 439 U.S. 959 (1978), that decision was reached over a vigorous dissent, and was only reluctantly followed by the same court in *United States* v. *Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979).

[13] 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy).

pose "to limit the 'snooping' that may be carried on under [the] bill." 97 Cong. Rec. 13377 (1951) (remarks of Rep. Hoffman).

GAO announced its interpretation of the bills during Congress' deliberations,[14] and that interpretation confirmed that the bills were intended to detect improprieties in the negotiation of specific procurement contracts.[15] GAO has since repeatedly conceded the narrow limits of its rights under the access statutes.[16] Indeed, GAO has urged Congress to grant broader access rights precisely so it could conduct industry-wide economic studies, such as that proposed here, using records of indirect costs, such as those at issue here.[17] Except for one

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[14] H.R. Rep. No. 791, 82d Cong., 1st Sess. 4-5 (1951); S. Rep. No. 603, 82d Cong., 1st Sess. 3-4 (1951).

[15] In similar letters to the House and Senate committee chairmen, GAO stated that the "purpose and intended effect" of the legislation was "clearly explained" by a passage from the House floor debates on the amendments to the First War Powers Act, in which Representative Celler emphasized that those amendments authorized GAO to determine whether contractors had been guilty of "fraud or overreaching or . . . anything untoward." H.R. Rep. No. 791, *supra*, at 4.

[16] *See e.g., Comptoller General Reports to Congress on Audits of Defense Contracts: Hearings Before a Subcomm. of the House Comm. on Government Operations*, 89th Cong., 1st Sess. 165 (1965); GAO Opinion No. B-162009-D.M. (Aug. 31, 1967); GAO opinion No. B-141683-D.M. (June 5, 1968); *The Military Budget and Nat'l Economic Priorities: Hearings Before the Subcomm. on Economy in Gov't of the Joint Economic Comm.*, 91st Cong., 1st Sess. 714 (1969) (testimony of Comptroller General Staats).

[17] *See, e.g.*, 115 Cong. Rec. 25800-01 (1969) (. . . legislation should be enacted broadening [GAO's] right of access to records . . . .); *id.* at 25793 (remarks of Senator Proxmire); *id.* at 25795 (remarks of Senator Ribicoff). *See also* S. 2049 and S. 3014, introduced in the 93d Congress, and S. 2268, introduced in the 94th Congress.

specific grant of authority that is irrelevant here,[18] Congress has steadfastly refused to permit GAO an expanded right of access. It was not until this litigation, nearly 25 years after passage of the access statutes, that GAO asserted the sweeping claims presented here. The Third Circuit properly rejected GAO's newly-broadened interpretation of the access statutes, holding that GAO's current interpretation "is inconsistent with the congressional intent and is entitled to no deference."[19]

Cost data cannot be "directly pertinent" to contracts when they were not offered or relied upon by the contractor, nor sought or relied upon by the agency, and when the determination of price was made upon the basis of factors that excluded cost. The "fraud" and "overreaching" that Congress sought to prevent[20] cannot occur where, as here, price was determined by reference to published catalogs or other evidence of the prices at which the goods are sold commercially in the public marketplace.

II.

The Industry-Wide Economic Study Sought Here By GAO Is A Misuse Of The Access Statutes

GAO seeks to use the access statutes for a purpose never authorized by Congress. Contrary to Congress' intention and GAO's own contemporaneous interpretation of the statutes, GAO does not seek to "make effective

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[18] Pub. L. No. 91-121, § 408, 83 Stat. 208 (1969). Enacted as part of the Military Appropriations Act of 1970, the legislation gave GAO narrow authority to conduct a single one-year study of defense industry profits.

[19] *SmithKline Corp.* v. *Staats*, 688 F.2d at 212; App. at 22a-23a.

[20] 96 Cong. Rec. 17123 (1951) (remarks of Rep. Celler).

audits," nor "check the transaction," nor challenge "erroneous or illegal payments."[21] The contracts involved here were selected randomly, without any claim of any possible impropriety, merely to furnish keys to SmithKline's confidential files. GAO's purpose is to study the economics of pharmaceutical manufacturing, which is precisely the kind of study for which GAO has repeatedly sought, and Congress has steadfastly refused, statutory authority. GAO's effort to employ the access statutes for such a study exceeds the narrow authority granted by Congress.

III.

Any Right Of Access Does Not Include Records Reflecting Indirect Costs

Even if GAO had some right to use non-cost-based contracts to compel the disclosure of cost data for use in an industry-wide economic study, any such right must be restricted to the direct costs of producing the specific products sold to the government. Any other standard would afford GAO essentially limitless access to a contractor's confidential records, even where the contractor had entered only into a single non-cost-based contract involving insignificant amounts. Such a result would deprive the statutory limitations of all meaning and ignore the intentions of Congress.

The Third Circuit correctly found that the legislative history of the access statutes "manifests a strong congressional intent to prevent unlimited 'snooping'."[22] Nonetheless, GAO claims a right to compel the disclosure

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[21] 97 Cong. Rec. 12611, 13198, 13197 (1951) (remarks of Rep. Hardy).

[22] *SmithKline Corp.* v. *Staats*, 668 F.2d at 210; App. at 20a.

of records reflecting all costs, whether or not they were incurred in producing the products sold under the contracts, if those costs are recouped from income to which government contracts contribute, even if that contribution is trivial.[23] As the Third Circuit held, GAO's interpretation "admits of no doctrinal limitation" and could even be used to justify "practically unlimited investigation of companies that do no direct business with the Government."[24] GAO's interpretation gives the statutory limitations "no effect."[25]

Consistent with the decisions of the District of Columbia and Second Circuits, the Third Circuit limited GAO's right of access to records reflecting the direct costs of producing the items sold to the government. In SmithKline's case, those include manufacturing costs and overhead, royalty expenses and delivery costs.[26] The court held that any broader right of access should, as GAO itself has repeatedly requested, be the result of legislation.[27] It

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[23] *Id.* at 211-12; App. at 21a-22a. *See also* the responses of the federal parties to SmithKline's Interrogatory Nos. 2 and 30, reproduced at C.A. App. 337, 354.

[24] *SmithKline Corp.* v. *Staats*, 668 F.2d at 211-12; App. at 22a. *See also Bristol Laboratories* v. *Staats*, 428 F. Supp. at 1390-91; *Merck & Co., Inc.* v. *Staats*, 529 F. Supp. at 3.

[25] *SmithKline Corp.* v. *Staats*, 668 F.2d at 211; App. at 22a.

[26] *Id.* at 214; App. at 27a. *See also Bristol Laboratories* v. *Staats*, 428 F. Supp. at 1391; *Merck & Co., Inc.* v. *Staats*, 529 F. Supp. at 3-4. SmithKline's accounting system is described in its responses to the federal parties' Interrogatory Nos. 4, 7, 10, 13 and 15, reproduced at C.A. App. 378-98.

[27] *SmithKline Corp.* v. *Staats*, 668 F.2d at 214; App. at 27a. *See also* the materials referred to above at n. 17.

noted that Congress, and not the courts, can "decide which information GAO needs to fulfill Congress' expectations."[28] If this Court holds that GAO has any right at all to compel the disclosure of cost records in the circumstances presented here, it should adopt the limitations already agreed upon by the Second, Third and District of Columbia Circuits.

CONCLUSION

The judgment below should be modified to deny GAO a right of access to any cost records. In the alternative, the judgment should be affirmed.

Respectfully submitted,

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[28] *SmithKline Corp.* v. *Staats*, 668 F.2d at 214; App. at 27a.

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 80-1464

SMITHKLINE CORPORATION,
Appellant

v.

ELMER STAATS, Comptroller General
of the United States, and
THE UNITED STATES OF AMERICA,
Appellees

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued July 16, 1981

Before: SEITZ, *Chief Judge*,
VAN DUSEN and HIGGINBOTHAM, *Circuit Judges*

(Filed December 28, 1981)

OPINION OF THE COURT

SEITZ, *Chief Judge.*

SmithKline Corporation appeals from a final judgment of the district court granting the Government's motion for summary judgment and holding that the Comptroller General (the Comptroller) has the right of access to records of costs "of materials, labor, overhead, distribution, research and development and marketing, and such other costs as are directly pertinent to the drugs purchased" under several contracts between the United States and SmithKline. *SmithKline Corp. v. Stauts*, 483 F. Supp. 712, 722 (E.D. Pa.), *conditional petition for cert. before judgment denied*, 449 U.S. 1038 (1980). This court has jurisdiction under 28 U.S.C. §1291 (1976).

I.

During 1973 and 1974, SmithKline entered into five negotiated contracts[1] to supply drugs to the Veterans Administration and the Defense Supply Agency. As required by statute, each contract contained an access-to-records provision granting the Comptroller access to "any directly pertinent" records "involving transactions related to this contract." *See* 10 U.S.C. §2313(b) (1976) (Defense Supply Agency); 41 U.S.C. §254(c) (1976) (Veterans Administration).

In 1971, Senator Gaylord Nelson, chairman of a subcommittee investigating the pharmaceutical industry, learned of the access-to-records provisions contained in certain government contracts and urged that the General Accounting Office (GAO) invoke the provisions: "I think that we ought to take a look at some of those costs." *Competitive Problems in the Drug Industry: Hearings on Present Status of Competition in the Pharmaceutical Industry Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business*, 91st Cong., 2d Sess. 8020 (1971). One of Senator Nelson's staff assistants, Ben Gordon, explicitly stated that specific cost and price data should be secured by individual company and product, and that "such data should be made public." Gordon demanded on behalf of Senator Nelson that the data be sought "through the courts if necessary," and "without any strings attached so that the information could be used as needed." Similarly, a

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1. In negotiated procurements, the Government discusses the terms of the procurement with one or more contractors, with the contract going to the candidate whose proposal is most advantageous to the Government. Negotiated contracts are to be distinguished from advertised procurements, which award contracts on the basis of competitive bids submitted by contractors. *See* Case Comment, *The Comptroller General's Authority to Examine the Private Business Records of Government Contractors:* Eli Lilly & Co. v. Staats, 92 Harv. L. Rev. 1148, 1148 n.1 (1979).

staff assistant to Senator Edward Kennedy, chairman of a Senate subcommittee on health, insisted that the "only way" the objectives of Senator Kennedy's subcommittee could be achieved was to "publicize specific price and cost data for individual products."

GAO finally concluded that it had "no viable alternative than to press the companies for access to their cost data." Initially however, GAO sought the voluntary participation of drug manufacturers. Its appeal was successful; SmithKline and five other manufacturers voluntarily participated in the first phase of a proposed two-phase study. In April 1974, GAO issued a proposal for "Phase II," designed to "gather and develop the data necessary" to make a "presentation concerning salient economic and operational aspects of the industry." The study was to cover research and development, manufacturing, marketing, distribution, and corporate overhead. GAO requested data relevant to all these aspects of the companies' business for the period between 1964 and 1973.

SmithKline expressed reservations about giving GAO access to such cost and pricing data without adequate guarantees of confidentiality. The Comptroller was prepared to give such guarantees in the interests of completing the study. Between April and August of 1974, GAO representatives met with Senate staff to seek their consent to the assurances of confidentiality. GAO emphasized that it would obtain "far more data" from voluntary disclosure, obtained on the basis of guaranteed confidentiality, "than we could demand under our statutory authority." The staff members were unpersuaded and refused to sanction any assurances of confidentiality.

On August 26, 1974, abandoning the concept of a voluntary study, the Comptroller issued formal demand letters, seeking access to the records of the companies that had participated in the Phase I study. This step was taken with the approval of Senator Nelson. GAO was un-

der no legal obligation to accede to the Senators' demands, and the demands had not been formally made by their respective subcommittees. GAO's sole reason for abandoning its voluntary program and resorting to formal demands was the Senators' refusal to approve any assurances of confidentiality.

GAO had no reason to believe that any impropriety had occurred in connection with the contracts, that any excess or unfair profits had been made, or that any violation of the law or other irregularity had occurred. All of the contracts selected by GAO for demand letters were fixed-price procurements, with prices established not by actual negotiation, but by reference either to catalogue prices for ordinary commercial items sold in significant quantities to the general public or to other evidence of a competitive price.

SmithKline filed this action seeking a declaratory judgment that the Comptroller lacked the authority to require the production of the data demanded.[2] The Government counterclaimed for declaratory and injunctive relief to compel SmithKline to comply with the Comptroller's demand. The district court granted the Government's motion for summary judgment, holding that GAO shall have access to all of SmithKline's cost records that the Government contended were directly pertinent to the price of the drugs sold under the contracts.

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2. This case is one of several recent challenges to the Comptroller's authority to examine the records of pharmaceutical companies pursuant to the access-to-records provisions. *See United States v. Abbott Lab.*, 597 F.2d 672 (7th Cir. 1979); *Eli Lilly & Co. v. Staats*, 574 F.2d 904 (7th Cir.), *cert. denied*, 439 U.S. 959 (1978); *Merck & Co. v. Staats*, No. 74-1447 (D.D.C. August 12, 1977), *aff'd per curiam*, Nos. 79-1435, 79-1438 (D.C. Cir. September 10, 1981); *Bristol Lab. Div. of Bristol-Myers Co. v. Staats*, 428 F. Supp. 1388 (S.D.N.Y. 1977), *aff'd per curiam*, 620 F.2d 17 (2d Cir. 1980), *aff'd by evenly divided court*, 101 S. Ct. 2037 (1981).

II.

SmithKline makes two main arguments on appeal: (1) that GAO sought information from SmithKline for an improper purpose; and (2) that the scope of the demand exceeds that allowed by the access-to-records provisions. The improper purpose argument raises three distinct issues: (a) whether GAO exceeded its statutory authority to audit the performance of particular Government contracts by demanding access to confidential financial records for the purpose of conducting a general study of procurement techniques or of conducting an economic survey of the profitability of the pharmaceutical industry; (b) whether GAO exceeded its statutory authority by demanding access to confidential financial records, at the instance of two Senators and their staff aides, in order to furnish the Senators with individual company and product data through the conduct of an economic survey of the profitability of the pharmaceutical industry; and (c) whether the district court erred in granting summary judgment because the court's interpretation of the record created a material factual issue regarding the actual purpose of GAO's demand.

SmithKline's arguments are premised on the principle that an agency that is given power to investigate for one purpose cannot use that power to pursue distinctly different, unauthorized goals. *See, e.g., United States v. LaSalle National Bank*, 437 U.S. 298, 307, 316-17 n.18 (1978) (IRS subpoena power); *United States v. Garden States National Bank*, 607 F.2d 61, 68 (3d Cir. 1979) (same); *United States v. Humble Oil & Refining Co.*, 488 F.2d 953, 954 (5th Cir. 1974) (holding that the IRS exceeded its authority in issuing a summons in furtherance of a project for which the primary purpose was research rather than the investigation and adjustment of tax liabilities), *vacated and remanded*, 421 U.S. 943, *reaff'd*, 518 F.2d 747 (5th Cir. 1975); *Burlington Northern, Inc. v. ICC*, 462 F.2d 280, 286 (D.C. Cir.) (ICC re-

quest for an injunction), *cert. denied*, 409 U.S. 891 (1972). Assuming, without deciding, that the contractual powers of GAO, a unique independent agency within the legislative branch, are subject to the same restraints as those on the subpoena powers of administrative agencies,[3] we proceed to examine whether the undisputed facts support SmithKline's assertion that GAO sought access for an improper purpose.

A.

SmithKline argues that GAO exceeded its limited authority to audit the performance of particular contracts under 10 U.S.C. §2313(b) and 41 U.S.C. §254(c) because it demanded access to confidential records for the stated purpose of conducting a general study of procurement techniques. The critical premise of such a position is that Congress enacted the access-to-records provisions to prevent profiteering and fraud, and not to sanction a general scrutiny of procurement techniques or an economic survey of a particular industry. According to SmithKline, Congress sought to deter specific abuses and not to permit general investigations of the records of companies which are not in any way suspected of fraud or impropriety in their dealings with the Government.

The provisions were certainly intended to authorize access to records in cases of suspected fraud and profiteering. *See, e.g.*, 97 Cong. Rec. 13,200 (1951) (remarks of Rep. Riehlman); 96 Cong. Rec. 17,123 (1951) (remarks of Rep. Celler). Nevertheless, given that such was the primary concern, it does not necessarily follow that

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3. *See Eli Lilly & Co. v. Staats*, 574 F.2d 904, 909 (7th Cir.), *cert. denied*, 439 U.S. 959 (1976); Cibinic & Lasken, *The Comptroller General and Government Contracts*, 38 Geo. Wash. L. Rev. 349, 350 (1970) (GAO operates "on the hazy borderline between legislative and executive powers"). *Cf.* Case Comment, *supra*, at 1154-56 (discussing whether GAO is an agency).

no other purposes for the provisions exist. There is a fine line between profiteering and wastefulness, and the vast majority of the legislative references to the provisions do not indicate an intent to restrict their use to situations involving impropriety. The problems of noncompetitive pricing detailed in the congressional debates include waste in Government procurement. Representative Hardy, the sponsor of the access-to-records provisions, summarized the congressional purpose as follows: "The major purposes of this bill are twofold: One, to give the Comptroller General the proper tools to do the job the Congress has instructed him to do; and, two, to provide a deterrent to improprieties and wastefulness in the negotiation of contracts." *Id.* at 13,198. Representative Hardy further explained that examination of contractors' records by the Comptroller would enable "the General Accounting Office to look behind the [price] which had been established [to assess whether it was] excessive" and would act as a "safeguard against waste and extravagance" in Government procurement. *Id. Cf. Schwegmann Brothers v. Calvert Distillers Corp.*, 341 U.S. 384, 394-95 (1951) (sponsor's statement of purpose is persuasive indication of congressional intent). Representative Hoffman remarked in the course of the debates that "GAO is the most effective agency we have against fraud and extravagance and waste and all those things." 97 Cong. Rec. 13,373 (1951). *See id.* at 13,199 (remarks of Rep. Hardy) (Congress "clearly understood . . . that there are a lot of other situations besides those involving fraud which might be uncovered").

SmithKline points to passages in the legislative history indicating that Congress intended only to detect fraud and profiteering with the access provisions. *See id.* at 13,373 (remarks of Rep. Hardy) (reassuring the House that exercise of the provisions would not be routine but that GAO could invoke them if it has "reason to suspect fraud or bad faith or illegality" in connection

with the contract); *id.* at 12,611 (remarks of Rep. Hardy) (stating the "sole purpose of the bill is to enable the Comptroller General to make effective audits along the lines and under the jurisdiction conferred upon the General Accounting Office by law"). We are not convinced, however, that these scattered statements are indicative of the thrust of the legislative history. The most reasonable construction of the access-to-records provisions is that Congress has authorized GAO to uncover waste by invoking them.

We also find support for our interpretation of the statute and its legislative history in the case law. *See Merck & Co. v. Staats*, Nos. 79-1435, 79-1438, slip op at 3 (D.C. Cir. September 10, 1981) (Mikva, J., concurring in part and dissenting in part); *United States v. Abbott Laboratories*, 597 F.2d 672, 674 (7th Cir. 1979); Eli Lilly & Co. v. Staats, 574 F.2d at 915-16. *But cf.* Note, *Government Contracts: Contractor's Obligation to Allow Examination of Records Under 10 U.S.C. §2313(b)*, 72 Dickinson L. Rev. 687, 691 (1968) (stating that access provisions were intended "solely to provide a method to discover fraudulent activities," but recognizing that "there is nothing in the Act specifically negating" the possibility that Congress sought to improve general procurement techniques).

Although the statute and its legislative history do not specifically indicate that Congress intended to authorize GAO studies of procurement techniques, they authorize GAO to seek information that will help the Government reduce wastefulness and that is "directly pertinent" to the contract. Acquiring data for studies of procurement techniques seems a reasonable means to the end that Congress intended. In light of our own review of the statutes and their legislative history, we are unpersuaded that GAO's interpretation of the access-to-records provisions as allowing such access is unreasonable. *See Hewlett-Packard v. United States*, 385 F.2d

1013, 1016 (9th Cir. 1967) (noting that, if production costs are "out of line with the contract price, the contract may have been an inappropriate means of meeting this particular procurement need. . . . [and this approach] could lead to the use of other methods of meeting future procurement needs"), *cert. denied*, 390 U.S. 988 (1968).

Great weight is traditionally accorded to the construction of a statute by the agency charged with its administration "unless there are compelling indications that it is wrong." *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1969). SmithKline points to evidence that GAO has expressly and impliedly indicated, in letters to congressional committees at the time the statute was enacted, in internal memoranda, and in recommendations that Congress grant it additional authority, that it lacks the power to examine records relating to nongovernment business activities or to conduct "should cost" studies. SmithKline also contends that GAO has never previously conducted economic "industry" studies. At the most, SmithKline's evidence suggests that the GAO has changed its interpretation. More likely, GAO's interpretations represent GAO's search to discover which tasks are reasonably related to its responsibility for overseeing Government purchases. In any case, we believe that GAO has correctly concluded that it has the statutory authority to make the studies that it has proposed.

Nor do we think it determinative that Congress has only once granted GAO a right of access to records of government contractors for the purpose of conducting an economic study, or that in 1973 and 1975 Congress declined to act on several proposals drafted by GAO that would have granted GAO access to contractors' records in order to conduct profit studies of Government contractors. *See, e.g., American Trucking Associations v. Atchison, Topeka & Santa Fe Railway*, 387 U.S. 397, 418 (1967) (agency's request for legislation is not re-

garded as administrative interpretation of enabling statute); *United States v. UMW*, 330 U.S. 258, 281-82 (1947) (subsequent legislative history declaring intent of an earlier statute not controlling). Relying on the fact that Congress did not pass a bill to interpret a bill that Congress passed many years earlier is inherently suspect. Such inaction certainly does not indicate that Congress itself has concluded that the provisions themselves do not grant authority for the studies. The issue here is whether the access-to-records provisions now before us can reasonably be read to permit the GAO's present demand. We conclude that they can.

Assuming that GAO actually seeks SmithKline's records for the purpose of conducting an economic study of the pharmaceutical industry, we believe that it is a small step to find that the Comptroller's audit responsibilities include the study not only of the firms that contract with the Government but also the industries of which the firms are a part. GAO must have some understanding of an industry before it can study an individual procurement effectively. The Comptroller's Phase II demand in this case is equivalent to a request for access to records relevant to a cost-price comparison of each contract for the purpose of determining whether there has been "wastefulness" in pharmaceutical procurement. That the GAO will facilitate its comparison by compiling an industrywide economic study or procurement techniques study does not vitiate that purpose.

B.

SmithKline also argues that the record clearly demonstrates that GAO seeks access to SmithKline's confidential business records to undertake an economic study of the pharmaceutical industry in response to intense and continuing pressure from two Senators and their staff aides who wish to obtain, for public disclosure cost and pricing data relating to specific products and manu-

facturers.[4] Assuming, as we must, for purposes of reviewing the district court's summary judgment, that SmithKline could prove that GAO is seeking to obtain information for an industrywide economic study that would provide Senators Nelson and Kennedy with the information they sought, we cannot hold that GAO's purpose is improper. The statutory requirement that the access-to-records provision be included in the contracts establishes the public interest in uncovering wastefulness and extravagance. That United States senators encourage and influence GAO to use its powers to the fullest extent allowed by law, and that GAO heeds those Senators, is irrelevant. *See* Parnell, *Congressional Interference in Agency Enforcement: The IRS Experience*, 89 Yale L.J. 1360, 1368 (1980), quoting *Gravel v. United States*, 408 U.S. 606, 625 (1972) (noting that "members of Congress 'are constantly in touch with the Executive Branch of Government — they may cajole, and exhort with respect to the administration of a federal statute' "). We believe that a demand letter issued by GAO pursuant to its statutory authority, under the continuing and intense pressure of United States senators, may not, with-

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4. We do not understand SmithKline's argument to be that, assuming GAO lawfully has acquired information — under the pressure from the Senators — for the purpose of preparing an industrywide economic study, it cannot turn it over to individual senators. Rather, we believe that SmithKline's argument is simply that "the central purpose underlying the Comptroller General's demands was to obtain exploitable cost information, desired by two Senators and their aides, through the conduct of a broadranging study of the economics of the pharmaceutical industry." We therefore need not address what limits, if any, exist on GAO's ability to disclose information obtained by invocation of the access-to-records provisions.

The parties have agreed to provisions that substantially protect the confidentiality of the records. *See SmithKline*, 483 F. Supp. at 723-24 (confidential information may only be disclosed if: (1) identification of SmithKline as the source of the information is impossible; (2) if a committee or chamber of Congress requests the information; or (3) if a subpoena is issued for the information).

out more, be resisted on the ground that GAO sought the information for an improper purpose.

In *SEC v. Wheeling-Pittsburgh Steel Corp.*, 648 F.2d 118 (3d Cir. 1981) (en banc), we indicated that "we will not countenance judicial interference with agency decisions to conduct investigations, decisions that are committed entirely to agency discretion. . . ." *Id.* at 127 (citing, e.g., *City of Chicago v. United States*, 396 U.S. 162, 165 (1969)).[5] The reason for this policy of noninterference was recently stated by the United States Court of Appeals for the Fifth Circuit: "Judicial supervision of agency decisions to investigate might hopelessly entangle the courts in areas that would prove to be unmanageable and would certainly throw great amounts of sand into the gears of the administrative process." *Dresser Industries, Inc. v. United States*, 596 F.2d 1231, 1235 n.1 (5th Cir. 1979), *cert. denied*, 444 U.S. 1044 (1980). We believe those same concerns support our result in this case. Moreover, although the courts that have considered whether GAO may investigate fraud and whether it was motivated by a proper purpose in investigating the pharmaceutical industry have taken an approach different from our own, *see Lilly*, 574 F.2d at 910-12 (finding speculation about senatorial prodding unnecessary if GAO otherwise has a legitimate purpose); *Merck*, slip op. at 4-5 (Mikva, J., concurring in part and dissenting in part) (same); *SmithKline*, 483 F. Supp. at 720-21, no court has found that GAO is pre-

5. In *Wheeling-Pittsburgh*, this court recognized that the enforcement of an SEC subpoena may be challenged where the agency is abusing the court's process. *See* 648 F.2d at 125. Although this case was called to counsels' attention at oral argument, SmithKline does not contend that this case is controlling in the present circumstances. Indeed, SmithKline does not allege that GAO is acting in bad faith in seeking access to the information. *Cf. id.* at 125 n.9 (defining agency bad faith as "a conscious decision by an agency to pursue a groundless allegation without hope of proving that allegation").

cluded from demanding records from pharmaceutical firms because of an improper purpose.

C.

SmithKline argues that at a minimum this court must decide that material issues of fact regarding the actual purpose of the Comptroller exist, thus rendering summary judgment for the Government inappropriate. We have concluded, however, that, assuming GAO sought to conduct a broad economic study of the pharmaceutical industry in order to provide cost and pricing data to individual Senators, GAO did not invoke the access-to-records provisions for an improper purpose. Thus, SmithKline's contention is without merit, because the issue as to the Comptroller's actual purpose is not material to our legal conclusion.

III.

SmithKline also alleges that the district court erred in its determination of which records may be considered "directly pertinent" to "transactions relating to" the contracts. SmithKline makes two arguments as to the scope of access: (1) cost records are pertinent only to cost-based contracts; and (2) even if some cost data is pertinent to fixed-price contracts, the district court failed to set any reasonable limits on the scope of GAO's access.

A.

The five contracts at issue are fixed-price contracts. The prices were established by reference either to catalogue prices for ordinary commercial items sold in significant quantities to the general public or to other evidence of competitive price. SmithKline argues that cost data cannot be "directly pertinent" to "transactions related to this contract" where the price is fixed not in refer-

ence to a standard of fairness in negotiating or to costs, but to catalogue, market, or competitive prices. In support of this interpretation of sections 2313(b) and 254(c), SmithKline points to limitations in the Truth-in-Negotiations Act, 10 U.S.C. §2306(f) (1976), and in the Renegotiation Act of 1951, 50 U.S.C. §1216(e) (1976), on the submission of cost data for the negotiation or renegotiation of contracts based on established catalogue prices or adequate price competition. SmithKline argues that these statutes and the regulations promulgated thereunder provide important evidence that similar restrictions are incorporated in sections 2313(b) and 254(c) through the language limiting access to material "directly pertinent" to "transactions relating to" the contract. SmithKline contends that, in the absence of convincing evidence that different interpretations were intended, interrelated statutory provisions should be given a harmonious construction. *See Kokoszka v. Belford*, 417 U.S. 642, 650 (1974). SmithKline maintains that in this area of Government procurement Congress has consistently recognized that the presence of competition is a sufficient substitute for other safeguards against contractor abuse.

Both the statutory and the contractual provisions clearly apply by their terms to negotiated contracts without qualification. If Congress had desired to exclude fixed-price contracts from the provisions' operation, it could have explicitly done so, as it did in the Truth-in-Negotiations Act and in the Renegotiation Act. *See Lilly*, 574 F.2d at 916; *Hewlett-Packard*, 385 F.2d at 1016. Moreover, SmithKline's contention that the access-to-records provisions do not extend to costs conflicts with the language of the provisions. Not only has SmithKline contracted to disclose some "directly pertinent" records in its possession, but it has also contracted to put a provision in its subcontracts securing access for GAO to the "directly pertinent" records of its subcontractors. If the position now urged by SmithKline that the

statute and contract do not allow access to any cost records is correct, the provision for access to the records of SmithKline and of its subcontractors would be a nullity. The purpose of the access-to-records provision is to allow GAO to assess the reasonableness of the contractors' costs and pricing by insuring full access by the Comptroller to all directly pertinent cost and pricing records, including subcontractors' records that otherwise might be unreachable because they would not be in the custody and control of the contractor. Thus, SmithKline's reading ignores a large portion of the provision itself and violates the well-established rule that a contract and a statute should be read so as to give meaning to all their provisions.

SmithKline argues that, because the access-to-records provisions are dictated by statute, they cannot be individually tailored to meet the specific requirements of each contract. The Government, SmithKline contends, can take no comfort from the fact that the access clauses seem to envisage the production of subcontractor records that appear to be relevant to the issue of costs and pricing. This clause is required by the statute whether or not SmithKline planned to use subcontractors in the performance of the particular contract. SmithKline argues that similarly the clause is required whether the subcontractor's performance will be "directly pertinent" to the particular contract or not.

Congress has by statute required a provision in every contract that in some instances has no application because the contractor does not employ a subcontractor. The possibility that a standard contractual provision will have no application in one contract does not, however, render it meaningless in another contract where it could have application. Thus, we think that cost records can be directly pertinent to fixed-price contracts and that an access-to-records provision in such a contract gives GAO the authority to request directly pertinent data. *See Lilly*, 574 F.2d at 916.

B.

Determining that the statutory provision does not exempt fixed-price contracts does not necessarily mean that all costs that affect the price of the drug covered in the contract are directly pertinent to the contract. Representative Hardy used the following examples to illustrate the situations which his bill was designed to reach:

> It is common practice today to provide in a contract for construction work a fixed overhead rate, either as a proportion of direct labor costs or as a lump sum amount. . . .
>
> If in the course of checking the accounts of the accountable officer, the GAO found a situation indicating that the amount of overhead charged under the Government contract was a great deal higher than the amount paid under a private contract for the same work, it would then obviously be desirable for the General Accounting Office to look behind the rate which had been established. . . .
>
> During the last war, there were cases where contractors held both fixed-price and cost-plus-a-fixed-fee contracts covering similar items or services, both contracts being performed simultaneously and in the same plant. In several cases it was found that the contractor was charging to the cost-plus-a-fixed-fee contract expenses which should have been charged to the fixed-price contract. In that way he was being reimbursed for expenses which should have been paid out of his own pocket. Such a practice may, or may not, have been intentional. But in any event, there would be little or no chance of detecting such a practice, unless the General Accounting Office has access to the contractors' books and records.

97 Cong. Rec. 13,198 (1951). For GAO to detect a differential allocation of overhead costs between governmen-

tal and nongovernmental contracts, or between cost-plus and fixed-price contracts, it would have to examine a very broad set of records. *See* Case Comment, *supra*, at 1157-58 n.67. The implication of Representative Hardy's examples is that the legislation was intended to authorize inquiry not only into all costs associated with each negotiated government procurement contract, but also into all similar contracts between a particular contractor and his private buyers, in order to determine whether the government was bearing an excessive share of the company's fixed costs. It is clear, however, that Congress did not intend the "directly pertinent" language to allow GAO to examine records of costs recovered exclusively from nongovernmental contracts. *See Merck*, slip op. at 27 (Mikva, J., concurring in part and dissenting in part); Memorandum on the Adequacy of the Legal Authority of the General Accounting Office to Conduct a Comprehensive Study of Profitability in Defense Contracting, *reprinted at* 115 Cong. Rec. 25,800 (1969) [hereinafter GAO Memorandum] (GAO has taken the position "that the words 'directly pertinent' were intended only to limit GAO's right of access to records pertaining to Government work as distinguished from non-government work").

The bill that contained sections 2313(b) and 254(c) originally limited the Comptroller to "pertinent" records of the contractor. Representative Hoffman emphasized in debates over the access-to-records provision that he objected strongly to "snooping expeditions" and that the access-to-records provisions would allow GAO "unlimited authority to go everywhere and snoop into everybody's business." 97 Cong. Rec. 13,373 (1951) (also stating opposition to a statute that "would let GAO go into everybody's business and look it over"). To prevent an expansive interpretation of the provisions, Congress restricted the access proposal even further, by specifying that only records "directly" pertinent to the contract may be demanded. Representative Hoffman,

who sponsored the limiting amendment but opposed the original bill, *see* 97 Cong. Rec. 13,377 (1951), stated specifically that the purpose of the modifying language was to "limit the 'snooping' that may be carried on under this bill." *Id.* Representative Hoffman emphasized that, unless the proposed bill were limited, even a small government contract would open all of a contractor's records to inspection by GAO. He pointed out that, without amendment, the provisions would permit a contract for ten percent of a contractor's production to be inspected by GAO "not only with reference to that one item of 10 percent . . . but into all of his other business where that same item was used." *Id.* He feared this result because the contractor would inevitably fail to keep "a separate set of books" for his government business, so that: "every section of his books will have to come under the complete scrutiny of the GAO. He is going to be harassed no end to try to break down production costs and show the details. . . ." *Id.* at 13,376 (remarks of Rep. Harvey). Although these statements were offered in support of a proposed amendment relating to subcontractors, we believe that the same apprehension stimulated the introduction and adoption of the limiting "directly pertinent" language.

The Government argues that Congress' addition of the word "directly" did not sharply narrow the scope of inquiry to be allowed GAO. *See* Case Comment, *supra*, at 1157-58. *But see* Note, Eli Lilly & Co. v. Staats: *An Undue Expansion of the GAO's Investigatory Power Under the Access-to-Records Statutes*, 74 Nw. U.L. Rev. 122, 135 (1979) [hereinafter Nw. Note]. It is true that Representative Hardy did not oppose the amendment. *See* 97 Cong. Rec. 13,377 (1951). It is also true that Representative Hoffman did not indicate how his change would affect GAO's ability to secure specific documents. *See id.* On the other hand, a sponsor's statement of purpose generally is regarded as a persuasive indicator of congressional intent. *See Federal Energy Administra-*

tion v. Algonquin SNG, Inc., 426 U.S. 548, 564 (1976). In any case, we do not believe that the insertion meant nothing just because there was little debate on the change.

The legislative history manifests a strong congressional intent to prevent unlimited "snooping." "[W]hen Congress enacts a statute designed to limit government intrusion in the private affairs of its citizens, the statutory provisions must be followed scrupulously." *United States v. Bacheler*, 611 F.2d 443, 447 (3d Cir. 1979). We thus conclude that the contract does not provide for unlimited access to SmithKline's cost records.

When cost information is not allocated to specific contracts and their products, the Government's argument that generalized cost data are "directly pertinent" to any given contract is weakened. *See* Nw. Note, *supra*, at 132. Like most manufacturing businesses, SmithKline divides its costs into a small category of direct manufacturing costs that can be readily assigned to a particular product and into other categories of cost, including research and development, distribution, marketing, advertising, and administrative costs, which are not assigned to any one product. *See* Reekie, *Price and Quality Competition in the United States Drug Industry*, 26 J. Indus. Econ. 223, 235 (1978); Nw. Note, *supra*, at 132-33. *Cf.* National Association of Cost Accountants, *Research Series No. 29, Accounting for Research and Development Costs*, 36 N.A.C.A. Bull. 1375, 1427-30 (1955) (survey finding that some businesses assign research and development costs to particular products, but some do not because the arbitrary method of allocation would not be helpful). SmithKline maintains that this common practice reflects the lack of generally accepted accounting principles that permit accurate and meaningful allocation of these indirect costs.

Obviously, however, these unassigned costs affect the price charged for the company's products, because the company must recover both the costs directly as-

signed and the unassigned pooled costs. Manufacturing and distribution costs of individual pharmaceutical products may constitute as little as nine percent of the products' sale price. *See Lilly*, 574 F.2d at 913; Rucker, *Public Policy Considerations in the Pricing of Prescription Drugs in the United States*, 4 Int'l J. Health Services 171, 173 (1974).By characterizing unallocated costs as "directly pertinent" to government procurement contracts, GAO would be able to demand access to all records of pooled costs whenever the price charged the Government in the contracts at issue reflects costs attributable to the pool. GAO would thus have access to most, if not all, of SmithKline's pricing data.[6]

The Government, on the other hand, rejects both the argument that there are no generally accepted accounting principles that permit meaningful allocation of these indirect costs and SmithKline's suggestion that GAO's interpretation of the access provision would be without limits. The Government argues that SmithKline itself allocates costs to products and performs profitability studies for its own purposes; even if allocation of indirect costs to products cannot be made with scientific accuracy, it is helpful and necessary. The Government contends that there is almost no limit to the allocation of costs to particular products other than that set by expediency. The Government maintains, however, that it will not need certain information or information breakdowns and thus that its request for information is not without bounds. In short, the Government's contention is that any cost affecting the prices charged the Government under a given contract may be "directly pertinent" to the

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6. If GAO were allowed access to this information, it would presumably have to make a similarly arbitrary allocation. Thus, denying or granting access to such records will have little effect on GAO's ability to evaluate the contractor's pricing practices on a *particular* contract. *See* Nw. Note, *supra*, at 134. The information would, however, be useful in determining the extent of differential allocation between contracts.

contract. *See Lilly* 574 F.2d at 914-15 (finding that an item is directly pertinent to a contract if it is a "significant input" in the price of the product purchased in the contract).

We believe that the Government's argument undermines its own position, for it would seem that the Government's interpretation of "directly pertinent" admits of no doctrinal limitation on its access powers. We are unwilling to read the statutory provision as granting to GAO such broad discretion in determining what is pertinent and what is "snooping." The Government has not suggested a definition of "directly pertinent" that preserves the distinction between snooping and properly limited access. Indeed, its argument gives the phrase no effect in this case. If a "directly pertinent" cost record means any cost having a significant input into price, it would seem that GAO could also justify an extensive investigation of subcontractors who may actually be doing no Government business at all. *Cf.* Morgan, *The General Accounting Office: One Hope for Congress to Regain Parity of Power with the President*, 51 N.C. L. Rev. 1279, 1364-65 (1973) ("The same argument that would justify a GAO audit in *Hewlett-Packard* would justify an audit of contractors doing no government business at all."). We do not think that an interpretation of the "directly pertinent" language that allows practically unlimited investigation of companies that do no direct business with the Government can be sound in light of the congressional desire to prevent snooping.

The Government contends that GAO's administrative interpretation of "directly pertinent" should be followed in the absence of "compelling indications that it is wrong," especially where those interpretations were reported to Congress. We believe, however, that Congress' inaction in the face of the report should not be read as acquiescence. *See Girouard v. United States*, 328 U.S. 61, 69 (1946). GAO's broad interpretation of the provisions is inconsistent with the congressional intent and is

entitled to no deference. *Cf.* Nw. Note, *supra*, at 135 n.77 ("The GAO itself has been uncertain about the exact limits of its authority under the access-to-records statutes."). We must therefore search for a more limited interpretation if "directly pertinent" is to be given an interpretation consistent with the congressional history.

In some industries, costs such as research and development have such a small impact that they arguably are not "directly pertinent" to the contract and its price. *See Lilly*, 574 F.2d at 913-14. Whether a cost record is "directly pertinent" could vary from industry to industry. *See Merck*, slip op. at 26-27 (Mikva, J., concurring in part and dissenting in part). In some industries, direct costs are the predominant component of a product's price, and there would be no need to grant access to indirect cost information of those firms. But in the pharmaceutical industry, research and other costs not immediately attributable to one product form a large part of the costs of a pharmaceutical product. Each case could be decided on its facts by addressing one question: whether the records sought will show production costs and pricing of the contracts sufficient to determine why the contract price was fixed as it was and whether "the contract may have been an inappropriate means of meeting this particular procurement need of the Government." *Hewlett-Packard*, 385 F.2d at 1016. The judicial decision as to what records are necessary would thus be essentially an accounting problem which is not unlike those problems which are common in day-to-day discovery involving corporations. *See generally United States v. IBM Corp.*, 66 F.R.D. 186 (S.D.N.Y. 1974); Fed. R. Civ. P. 33(c).

Although it is tempting to take the opportunity to make the decision as equitably as possible in each case, we are not convinced that Congress intended for the interpretation of the access-to-records provision to depend on the facts of each case. The same provision appears in

most Government contracts. *See* Nash, *Risk Allocation in Government Contracts*, 34 Geo. Wash. L. Rev. 693, 694 n.3 (1966) (finding that only one quarter of all Government procurement contracts are advertised procurements). We believe that Congress intended the words to acquire some common meaning so that the Government and the contracting firm could know within reason what they were contracting to perform. In contracts involving many millions of dollars, many firms, and many products, certainty is more important than deciding each case on its facts.

In *Bristol Laboratories Division of Bristol-Myers Co. v. Staats*, 428 F. Supp. 1388 (S.D.N.Y. 1977), *aff'd per curiam*, 620 F.2d 17 (2d Cir. 1980), *aff'd by evenly divided court*, 101 S.Ct. 2037 (1981), the district court equated the directly pertinent costs with "manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision); manufacturing overhead (including plant administration, production planning, warehousing, utilities, and security); royalty expenses; and delivery costs." 428 F. Supp. at 1389. *See id.* at 1391. Specifically excluded, however, were data with respect to "research and development, marketing and promotion, distribution and administration (except to the extent that these areas may be included in the factors above)." *Id.* at 1389-90. The Government has not put forward an alternative definition of "directly pertinent" records that we should adopt if we do not agree with its interpretation of the statute. We therefore adopt the standard formulated in *Bristol*, which for the most part relies on the distinction between direct and indirect costs. We believe that it comports with Congress' intent to preclude GAO's scrutiny of nongovernmental contracts. Moreover, our distinction between information that is "directly pertinent" and that which is not follows the distinction drawn by every circuit to consider the issue with the exception of the Sev-

enth Circuit.[7] *See Merck*, No. 74-1447, slip op. 4-5 (D.D.C. August 12, 1977), *aff'd per curiam*, Nos. 79-1435, 79-1438 (D.C. Cir. September 10, 1981).

The Government argues that GAO's interpretation that the access-to-records provision provides for the access it seeks here has been well-known and judicially established since the *Hewlett-Packard* decision in 1967. We do not believe, however, that the Ninth Circuit sanctioned access to all indirect overhead cost data. The Ninth Circuit held that GAO should have access to "production costs." 385 F.2d at 1016. Although the court never defined these costs, the district court's order, affirmed by the court of appeals, referred specifically to "costs of direct material, direct labor and overhead costs." *Id.* Our decision includes direct costs and some overhead within its definition of "directly pertinent." How much overhead the Ninth Circuit intended to include is uncertain. *See Merck*, slip op. at 23 n.27 (Mikva, J., concurring in part and dissenting in part) ("Later decisions have disagreed over the *Hewlett-Packard* holding on this point."). *Compare Lilly*, 574 F.2d at 913, *with Bristol*, 428 F. Supp. at 1391. Thus, *Hewlett-Packard* does not necessarily suggest a result contrary to that in our case.

We have concluded that GAO may demand access to detect wastefulness and may make certain studies to help it in its task. We are aware, however, that the limiting interpretation that we have given the access-to-records provision may make it more difficult in some cases for GAO to obtain the information it may

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7. We note that in *Abbott Laboratories* another panel of the Seventh Circuit addressed precisely the same issues as those addressed in *Lilly*. The district court had granted summary judgment to the Government on the basis of *Lilly*, and the circuit court affirmed. Two of the three judges, however, specifically expressed reluctance and concurred in the affirmance solely because they considered themselves bound by the earlier decision. *See* 597 F.2d at 674 (Pell, J., concurring); *id.* at 675 (Wood, J., concurring).

need to uncover wastefulness.[8] Economic studies based on such restricted data may be of limited utility, and if the access provisions were meant to equalize the relationship between the Government and private contractors, our reading of the clause fails to advance fully that purpose in this case. *See* Merck, slip op. at 20-21 (Mikva, J., concurring in part and dissenting in part). The difficulty, however, arises because (1) the statute attempts to further the two conflicting congressional goals of limiting "snooping" and permitting broad access; and (2) the pharmaceutical industry presents special characteristics. The conflict in goals appears on the face of the statute itself. *Cf.* Nw. Note, *supra*, at 139 ("there can be no accommodation of the competing interests; either the GAO gets all of the information or it gets none of it"). For example, the fact that the demand is limited by the access-to-records provisions to data within three years of final payment, *see* 10 U.S.C. §2313(b), no doubt hampers the detection of wastefulness and the usefulness of any studies that are prepared. Congress also restricted GAO's investigatory powers by not making the access-to-records provisions applicable to advertised as well as negotiated contracts. Information on producers doing no business with the Government would undoubtedly also be useful in the overall improvement of Government procurements, since the data could be compared

8. In industries where direct costs are the prime component of price, where firms are producers of only one product, or where the firms sell almost everything they make to the Government, our decision will have little limiting effect on GAO's ability to make various studies. With other firms, manufacturing cost information alone might be useful for two purposes: (1) it might help to uncover fraud; and (2) where the products are part of a competitive market, which most fixed-price cost contracts, by definition, are, comparison of direct cost information could help the Government determine which company is assigning more overhead to its product. Nevertheless, we realize that our decision will limit to varying degrees GAO's ability to study any industry with firms that make several products or have several buyers.

with the data collected from companies contracting with the Government; but GAO cannot obtain that information under the provisions. *See* Morgan, *supra*, at 1364-65. We do not believe that we are free to ignore these limitations in trying to assure that GAO has meaningful access to the contractors' records.

GAO has itself recognized its dilemma: "While GAO's legal authority would permit it to perform some of the work necessary in making a profit study. . . ., to do a meaningful study of profitability . . . , legislation should be enacted broadening its right of access to records. . . ." GAO Memorandum, *supra*, *reprinted at* 115 Cong. Rec. 25,801 (1969). "In establishing the 'directly pertinent' standard as a limitation on the GAO's access rights, Congress apparently was willing to forego obtaining all the information that might be related to a government contract if the only alternative was to require a contractor to make available virtually all of its records." Nw. Note, *supra*, at 134-35 (footnote omitted). If "directly pertinent" information is not sufficient to make the Comptroller's investigation of certain industries complete, or if certain industries should be treated differently because of unique circumstances, Congress, and not this court, is better able to decide which information GAO needs to fulfill Congress' expectations.

SmithKline must allow GAO personnel to inspect its records with respect to manufacturing costs, manufacturing overhead, royalty expenses, and delivery costs. SmithKline need not produce data with respect to research and development, marketing and promotion, distribution and administration, except to the extent that these costs may be included in the manufacturing costs.

IV.

The order of the district court will be vacated and the case remanded for entry of an order consistent with this opinion.

Docket Sheet

NO. 81-1273-CFX (Vide: 81-1472)	TITLE	Charles A. BOWSHER, Comptroller General of the United States, et al., Petitioners v. Merck & Co., Inc.

DOCKETED	COURT
Jan. 7, 1982	United States Court of Appeals for the District of Columbia Circuit

DATE	PROCEEDINGS AND ORDERS
	Counsel for Petitioners: Solicitor General
	Counsel for Respondent: Ronald A. Stern
Nov. 27, 1981	Application for an extension of time to file petition for writ of certiorari and order granting same until January 8, 1982 by Burger, CJ, on Dec. 4, 1981.
Jan. 7, 1982	Petition for writ of certiorari filed. (Record filed).
Feb. 5, 1982	Brief for the respondent in opposition filed.
Mar. 23, 1982	Reply memorandum for the petitioners filed.
Mar. 24, 1982	DISTRIBUTED. 4-16.
Apr. 19, 1982	Petition GRANTED. The case is consolidated with 81-1472 and a total of one hour is allotted for oral argument.

June 8, 1982	The government will file its opening brief on July 2, 1982.
	Merck & Co. will file its brief on Aug. 2[6], 1982.
July 6, 1982	Brief for petitioners in 81-1273 filed. (Vide: 81-1472).
July 6, 1982	Joint appendix filed. (Vide: 81-1472).
Aug. 2, 1982	Brief, amicus curiae, of The Aerospace Industries Association of America, Inc. filed. (Vide 81-1472).
Aug. 6, 1982	Brief, amicus curiae, for Smithkline Corporation filed. (Vide: 81-1472).
Aug. 6, 1982	Brief for Merck & Co., Inc. filed. (Vide: 81-1472)
Sept. 13, 1982	Brief for respondents in No. 81-1472 and reply brief of petitioners in No. 81-1273 filed. (Vide: 81-1472).
Sept. 13, 1982	Order extending time to file the respondent's brief in 81-1472 and reply brief for the petitioners in No. 81-1273 until Sept. 14, 1982.
Sept. 15, 1982	CIRCULATED.
Nov. 10, 1982	Reply brief for Merck & Co., Inc. filed. (D). (Vide: 81-1472)
Dec. 1, 1982	ARGUED.